THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

THE BERKSHIRE GAS COMPANY	**)**	**D.T.E. 01-56**

INITIAL BRIEF

OF

THE BERKSHIRE GAS COMPANY

James M. Avery
Emmett E. Lyne
Robert E. Richardson
Rich May, a Professional Corporation
176 Federal Street
Boston, Massachusetts 02110
Tel: (617) 482-1360

Dated: November 21, 2001

TABLE OF CONTENTS

Page

Page

Page

Page

Page

Page

I. STATEMENT OF PROCEEDINGS

A. Procedural Summary and Overview of Berkshire Filing

Pursuant to M.G.L. c. 164, The Berkshire Gas Company ("Berkshire" or the "Company") filed revised schedules of rates and charges for gas service (rate schedules M.D.T.E 280-305, inclusive) with the Department of Telecommunications and Energy (the "Department") on July 17, 2001. The Company specified an effective date for such rate schedules of August 1, 2001. Such rate schedules, after appropriate adjustments, were designed to produce increased total annual revenues from the currently effective base rates in the amount of approximately $4,600,000 based upon a test period of the year ended December 31, 2000. This amount represents an overall increase of approximately 9% in total revenue.

In addition, consistent with Department precedent with respect to performance-based rates, the Company has proposed to implement a Price Cap Mechanism ("PCM," the "Plan" or the "PCM Plan"). The PCM is a ten-year rate plan that provides guaranteed benefits to customers pursuant to an initial rate freeze followed by a price cap and that is described in detail in section II infra. The PCM fully addresses in a manner consistent with Department precedent all issues relating to the September 1, 2000 merger, in which Berkshire became a subsidiary of Energy East Corporation ("Energy East" or "EEC"). The Company also proposed a number of rate design enhancements, including a load factor based Gas Adjustment Factor ("GAF"), therm billing for all distribution rates and an annual, rather than seasonal, rate design for distribution rates for all residential and the small commercial and industrial ("C&I") rate classes.

The proceeding to investigate the Company's proposals was docketed as D.T.E. 01-56.

The Company filed prepared written testimony of nine witnesses along with related supporting financial, informational and statistical schedules, material, data and documents. The

Company's witnesses were: (1) Robert M. Allessio, President and Chief Executive Officer of the Company; (2) Karen L. Zink, Vice President of Marketing and Resource Planning; (3) John J. Kruszyna, Manager of Internal Audit and Taxes for the Company; (4) Jennifer M. Boucher, Administrator of Rates and Planning of the Company; (5) Dr. Kenneth Gordon, Special Consultant with National Economic Research Associates, Inc ("NERA"); (6) Paul R. Moul, Managing Consultant of P. Moul and Associates; (7) James H. Aikman, Vice President of Management Resources International, Inc.; (8) Paul M. Normand, Management Consultant and President of Management Applications Consulting, Inc. ("MAC"); and (9) James L. Harrison, Management Consultant and Vice President of MAC. See Initial Filing, Exh. BG-1 to BG-38.

By order of the Department dated July 19, 2001, the effective date of the filed rates and charges was suspended until February 1, 2001. Hearings for public comment were scheduled and held in Pittsfield, Massachusetts on August 20, 2001 and in Greenfield, Massachusetts on August 22, 2001.

The Attorney General of the Commonwealth of Massachusetts (the "Attorney General") filed a Notice of Intervention on July 27, 2001. In addition, the Commonwealth of Massachusetts Division of Energy Resources (the "DOER") and the low-income weatherization and fuel assistance network, the Massachusetts Community Action Program Directors Association Inc., and the Low-Income Energy Affordability Network (collectively, "LEAN") filed petitions for intervenor status. The following entities filed petitions for limited participant status: (1) NSTAR Gas Company; (2) Western Massachusetts Electric Company; (3) the New England Division of the Southern Union Company; (4) Boston Gas Company d/b/a KeySpan Energy Delivery New England; (5) Fitchburg Gas and Electric Light Company; and (6)

Associated Industries of Massachusetts ("AIM"). The Hearing Officers allowed all such petitions without objection from the Company.

On October 1, 2001, the Attorney General filed a Motion to Dismiss the Petition of The Berkshire Gas Company and in the Alternative Bifurcate the Proceeding ("Motion to Dismiss") with respect to particular aspects of the service quality component of the PCM Plan. The Company filed a Memorandum in Opposition to the Attorney General's Motion to Dismiss on October 9, 2001 demonstrating that the Company's initial filing was fully consistent with the Department's recently issued service quality guidelines. The Department has not yet ruled on the Motion. On October 11, 2001, the DOER also filed a motion to strike portions of Dr. Gordon's testimony based upon an argument that Dr. Gordon was somehow not expert with respect to the PCM ("Motion to Strike"). On October 12, 2001, the Hearing Officer denied the Motion to Strike.[1] On October 15, 2001, the DOER appealed such ruling. The Company filed a memorandum in opposition to the DOER's appeal on October 24, 2001. The Department has yet to rule on the DOER's appeal.

The Department held 17 days of evidentiary hearings between October 3, 2001 and November 2, 2001 at its offices in Boston, Massachusetts. In accordance with normal Department procedures, various materials were also submitted during the course of the proceedings through certain information and record requests of the Department and intervenors, including updates to certain of the supporting financial, informational and statistical schedules, material, data and documents. The Attorney General also sponsored a single witness, Paul Chernick of Resources Insight, Inc.

---

[1] The Hearing Officer cited an interest in minimizing the cost of the proceeding in making his immediate ruling. Tr. 5, p.552; Cf. DOER In. Br., p. 6.

In accordance with the established procedural schedule, intervenors were required to submit their initial briefs on November 14, 2001. The Attorney General, DOER and LEAN submitted initial briefs while AIM filed comments. The Company now submits its initial brief and intervenors and interested parties will be permitted to file their responses to the Company's brief on November 30, 2001. The Company will then file a reply brief on December 7, 2001. As noted in the course of the proceeding, the Company's reply brief will be accompanied by an updated set of cost of service schedules (cf. Exh. BG-6) that reflect the arguments made by the Company in the brief and limited matters of updated information.

B. Case Background.

1. Berkshire's Balanced, Reasonable Approach to its First Base Rate Case in Nearly Nine Years

Berkshire has presented a balanced, appropriate and well-documented base rate filing in this proceeding. Berkshire's filing should be considered in light of well-established Department precedent, the substantial efforts of the Company to avoid a base rate increase for nearly nine years,[2] the substantial management achievements of recent years, and the guaranteed customer benefits associated with the PCM Plan that the Company is able to present only as a result of the September 1, 2001 merger of its parent, Berkshire Energy Resources ("BER"), whereby Berkshire became a wholly-owned subsidiary of Energy East. Tr. 2, pp. 162-166; Exh. BG-1, pp. 2-4, 7, 9-10.

Beyond the substantive bases for the adoption of the Company's proposed base rates and the implementation of the PCM, the Company believes that its presentation and procedural efforts in connection with this filing should be considered by the Department. After exhausting all practical alternatives,[3] the Company presented a comprehensive initial filing, including testimony of experienced Company executives and other experts well known to the Department such as Dr. Gordon and Messrs. Aikman, Moul, Normand, and Harrison. The Company presented its case in a straightforward and cost-effective manner, avoiding, as Mr. Allessio testified, "extreme positions." Exh. BG-1, p. 3. The Company focused upon the evidentiary issues and relied upon the strength of its case and the competence of its expert witnesses rather than motion practice. The Company responded to 535 information requests and 120 record requests on a timely basis and made its witnesses available for several additional hearing dates upon the request of Department staff or other parties. Cf. AG In. Br., p. 4. The Company also sought to apply judgment in an informed manner to contain rate case expense. See e.g. Exh. BG-3, pp. 22-23 (a total factor productivity analysis that may have had an "all in" cost as high as $500,000 was not performed in light of a recent Boston Gas study accepted by the Department that demonstrated a 0.0% factor); see also Tr. 1, p. 140; section II, infra. In sum, the Company presented a comprehensive, efficient and compelling substantive case in support of its proposed base rates and the adoption of the PCM.

---

[2] The Company's rates were "unbundled" pursuant to a revenue neutral process advanced by an industry-wide collaborative process initiated in response to Department directive in Berkshire Gas Company, D.T.E. 98-65 (1999).

[3] The Company submitted an interim rate proposal that would have provided for the recovery of certain costs associated with its new liquefied natural gas plant in the Local Distribution Adjustment Clause. See March 15, 2000 filing in docket D.T.E. 00-30/36. This filing was ultimately withdrawn. The Company also aggressively pursued settlement discussions with other parties in 2000 seeking to address its substantial revenue concerns. Exh. BG-1, p. 9.

2. The Need for a Base Rate Increase

With respect to the Company's diligent efforts to avoid a rate case, Mr. Allessio and Ms. Zink explained that Berkshire has not filed a request for a base rate increase in more than nine years. Since that time, Berkshire has experienced significant operating cost increases. In addition, Berkshire has recently added substantial and necessary plant investments. Exh. BG-1, pp. 9-17. Berkshire also noted its diligent and creative efforts to avoid a base rate filing. Id., pp. 9-17. Berkshire submits that these efforts were commendable, especially given low growth rates experienced within its service territory. Exh. BG-27, Table G-5.[4]

In terms of cost increases, substantial increases were experienced in a variety of areas, including, unit labor costs. Despite a variety of efforts in its overall cost reduction strategy, such costs have increased over the past nine years. Substantial capital investments since the Company's last base rate case, much of which are not revenue generating, have also driven the need for a rate filing. Most significantly, near the end of this long stay-out period, a major investment was necessary in a new liquefied natural gas ("LNG") plant in Whately, Massachusetts. The plant was necessary to address distribution reliability concerns regarding pressure and was found by the Department and the Energy Facilities Siting Board (the "Siting Board") to be the least cost resource to address such need. See Berkshire Gas Company, D.T.E. 99-17/EFSB 99-2 (1999). The plant also provides substantial flexibility benefits for customers.

The planning efforts associated with the LNG plant are representative of the nature of Berkshire's prudent least cost planning efforts since its last rate case. First, aggressive load

[4] The Company's service area has experienced many negative growth factors. The total population of Berkshire County decreased as reported in the most recent census. Exh. BG-1, p. 13. Labor force rates in Berkshire County decreased by 16.6% from 1991 to 1998. Exh. BG-27, p. 25.

management, targeted conservation programs and creative engineering applications were all applied over more than ten years to defer the need for the plant. This aggressive application of least cost planning has secured substantial benefits for customers and should be recognized by the Department. Second, the plant was the product of an innovative, flexible and least cost planning process.[5] Exh. BG-1, pp. 11-12; Tr. 2, p. 178. The design of the plant also facilitates a closer matching of construction costs to demand, as additional tanks can be added in the future as needed.

Numerous other measures were implemented by the Company to control costs. As part of a total labor cost reduction strategy, employee cross-training efforts were pursued resulting in a leaner, more flexible staff. Exh. BG-1, p. 10. Importantly, staffing reductions were made across the board. The Company maintained four officers and two director positions at the time of its last rate proceeding. Today, the Company has only two officers on its payroll (exclusive of its Clerk) and one director level executive. Indeed, the Company's non-union payroll expense has decreased since its last base rate proceeding. See Section III.C.3.a infra.

Another significant factor that led to the rate filing was the Department's policy decision in Colonial Gas Company, D.P.U. 97-112 (1999) limiting lost base revenue ("LBR") recovery relating to demand-side management ("DSM") programs. This statewide policy change resulted

---

[5] The planning process involved substantial coordination with local stakeholders. Berkshire has long been committed to working with interested parties in a cooperative and productive manner. Berkshire Gas, D.T.E. 99-17/EFSB 99-2, pp. 34, 35, 38 (the Department and Siting Board found that it had been "beneficial" to include community input in the site selection process). An additional example of this commitment is the fact that each and every DSM program implemented by the Company has been established pursuant to a settlement with one or more relevant stakeholders. Exh. BG-1, p. 15.

in a loss of approximately $500,000 of revenue for Berkshire in 2001, an amount the Company simply cannot sustain on a going forward basis.

In sum, the Company implemented numerous procedures and took aggressive actions to avoid filing a base rate case and sought all practicable procedural options as well. Only after exhausting these options did Berkshire determine that it was necessary to file this case. The core of the Company's filing is the PCM, described in Section II, infra. The PCM guarantees benefits to customers for the next decade.

II. BERKSHIRE'S TEN-YEAR PRICE CAP PROPOSAL PROVIDES MAJOR BENEFITS TO CUSTOMERS AND IS CONSISTENT WITH WELL-ESTABLISHED DEPARTMENT PRECEDENT AND SOUND REGULATORY POLICY.

A. Overview of Berkshire's PCM Plan.

1. Introduction to the PCM.

Berkshire has developed and proposed a well-balanced and carefully crafted PCM Plan that provides substantial benefits to customers, is consistent with Department precedent and comports with sound regulatory and economic policy. The PCM Plan was developed by Berkshire with the expert assistance of NERA and its widely respected Special Consultant, Dr. Kenneth Gordon, the former Chairman of the Department. In developing the PCM, Berkshire and NERA reviewed state-of-the-art incentive ratemaking approaches employed throughout the nation, with a special focus on approaches approved in Massachusetts. Exh. BG-1, p. 21.

As described in the testimonies of Ms. Zink, Dr. Gordon and Mr. Allessio, the Company is proposing a PCM Plan which will have a term of ten years following the establishment of just and reasonable "cast off" rates in this proceeding, annual price adjustments (including an inflation adjustment) after an initial price freeze of 31 months, a guaranteed annual consumer dividend (in the form of an annual 1% **reduction** to base rates), a mid-period review to enhance stability, potential adjustments for exogenous costs (whether positive or negative) and the implementation of service quality measures that directly incorporate the rigorous statewide guidelines ("Guidelines") recently adopted by the Department in Service Quality Standards, D.T.E. 99-84 (June 29, 2001) ("D.T.E. 99-84"). Exh. BG-22, p. 9. The specific terms and conditions of the Company's proposed price-cap plan are detailed in the PCM term sheet attached to Exh. BG-23 as Exhibit KLZ-1 (the "Term Sheet").[6] In general, these terms closely follow the terms of the price-cap plan approved for Boston Gas Company in the Department's seminal order, Boston Gas Company, D.P.U. 96-50 (1996) ("Boston Gas, D.P.U. 96-50" or "D.P.U. 96-50").

As described in section II.B.1, infra, an essential element of the Plan is the establishment of just and reasonable cast off rates that will enable the Company to provide quality and reliable service over the ten-year term of the Plan. Under the PCM, the Company's cast off rates accurately reflect the cost structure for the Company on a stand alone basis, without the inclusion of any merger-related costs (e.g., acquisition premium or transaction costs) with respect to the September 1, 2000 merger of Berkshire Energy Resources and Mountain Merger, LLC, the wholly-owned merger subsidiary of Energy East. Exh. BG-1, pp. at 21-22. The Company's

[6] Dr. Gordon summarized the PCM in his testimony as follows: "Following a 31-month rate freeze, Berkshire's proposed price-cap plan would go into effect. Berkshire's proposed price-cap component is similar in structure to the standard price-cap model used in Massachusetts. The price-cap component is the sum of five factors: (1) a broad-based U.S. price index (GDP-PI); (2) a base productivity offset (X-factor), which would be enhanced by a consumer dividend to provide an additional assurance that consumers benefit from the Plan and to share the possible benefits of the merger with customers; (3) an exogenous change passthrough factor, which would allow the utility to recover certain costs (and lost revenues) brought on by conditions beyond its control; (4) a mid-period review; and (5) a mechanism to address the possibility that the Company's service quality and reliability might decline." Exh. BG-3, p. 20.

proposal not to include these merger-related costs[7] in return for the opportunity, but not the guarantee, of generating off-setting merger-enabled benefits over the term of the PCM is a core element of the PCM Plan that provides important benefits for customers. Exh. BG-3, pp. 12-14; Exh. BG-1, p. 23. As described below, however, the PCM Plan is presented as a carefully integrated package, with each component relating to the entire plan, and in the event certain core elements of the plan are modified materially, the Company must reserve the right to revisit such issues. Tr. 8, p. 971. The Company is confident, however, that the record clearly establishes that its PCM is well-reasoned, balanced and consistent with Department precedent and merits the approval of the Department.

2. **Berkshire's PCM Plan is Consistent with Precedent and Provides Major Benefits.**

As detailed below, each element of Berkshire's PCM Plan is consistent with Department precedent. In addition, the price cap components of the PCM Plan are designed to reflect the fact that Berkshire has, de facto, operated pursuant to a price cap for over eight years and has already eliminated so-called "accumulated inefficiencies." Exh. BG-3, p. 14; Tr. 1, pp. 70-71. Indeed, Berkshire's test year non-union payroll expense has decreased since its last test year (1991). See Exh. BG-6, Schedule JJK-8 and Exh. BG-9, Supp. Sch. NU-F, c.f., The Berkshire Gas Company, D.P.U. 92-210 at 34 (1992). Berkshire's ability to operate without base rate relief for such a long

---

[7] As set forth in Exh. AG 10-12, the Company had booked $66,263,858 in merger-related goodwill allocated to the Company, including a portion of the acquisition premium for Berkshire Energy Resources and related transaction costs. The Department has consistently allowed an opportunity for the full recovery of merger-related costs through rates provided that such recovery does not result in "net harm" to customers. See, e.g., Boston Edison Company, et al., D.T.E. 99-19 (1999); Eastern Enterprises/Colonial Gas Company, D.T.E. 98-128 (1999); Northern Indiana Public Service Company/Bay State Gas Company, D.T.E. 98-31 (1998);

period contrasts favorably with other Massachusetts companies that implemented base rate increases every two to three years prior to their adoption of price cap plans.[8] As Dr. Gordon and Mr. Allessio testified, Berkshire has been very successful in addressing efficiency issues and, accordingly, its Plan should be viewed as a "second generation" price cap. Exh. BG-1, p. 21; Exh. BG-3, pp. 14-15.

The Company's PCM Plan is what Dr. Gordon describes as a relatively pure plan. Namely, there is no earnings bandwidth outside of which the Company shares the risk of sub-par earnings with utility customers or shares higher than anticipated earnings with utility customers. Id. at 10, n. 7; p. 27. Berkshire is willing to assume the risk of elimination of an earnings "floor" on a going forward basis in return for the opportunity to enhance earnings in the event its performance merits it and to recover its merger-related costs. Such a pure plan also results in more substantial administrative benefits because neither the Company, the Department nor stakeholders need continually to calculate and review Berkshire's earnings. Exh. BG-1, pp. 23-24. Indeed, the review of each annual adjustment filing should be straightforward and in the nature of a compliance filing review similar to the review of typical CGAC adjustment filings. Additionally, Berkshire’s proposed mid-period review ensures that the Department has the opportunity to verify that the plan, as actually implemented over time, remains in the public interest. Exh. BG-1, p. 22-24.

Berkshire’s PCM Plan provides customers with outstanding rate stability and predictability (a concern also addressed in its rate design) and ensures that distribution rates will

---

Eastern Enterprises/Essex County Gas Company, D.T.E. 98-27 (1998); New England Electric System/Eastern Utilities Associates, D.T.E. 99-47 (2000).

decrease in real terms over the PCM Plan period due to the guaranteed consumer dividend (absent any unexpected exogenous costs). As noted above, the PCM Plan also provides Berkshire and EEC with an opportunity to recover proper merger-related costs, but only if greater efficiencies are achieved. Exh. BG-3, p. 17. Thus, customers are ensured of benefits from the merger because all merger-related costs have been stripped out of base rates. Importantly, the plan achieves these objectives without compromising safety or the quality of service to customers due to two factors: 1) fair "cast off" rates that ensure that the Company has adequate resources to provide excellent service; and 2) the adoption of the Department's generic service quality Guidelines that guarantees that the Company will continue to provide high quality service or face significant financial penalties. Exh. BG-1, pp. 20-21.

In terms of benefits to the Commonwealth, the PCM should generate more competitive prices at the burner tip (which are enhanced by the merger-enabled gas commodity cost savings resulting from the Department-approved BP Alliance), which in turn will provide economic benefits to all gas customers and encourage industry in the Company's service area. Exh. BG-1, pp. 22-25.[9] Further, the streamlined design of the PCM Plan (including a ten-year rate case "stay out") will reduce administrative burdens and expense for the Department, the Company and other interested parties. Id.

---

[8] See *e.g.*, Boston Gas Company, D.P.U. 88-67 (1988) (base rate case); Boston Gas Company, D.P.U. 90-55 (1990) (base rate case); Boston Gas Company, D.P.U. 93-60 (1993) (base rate case); Boston Gas Company, D.P.U. 96-50 (1996) (final order adopting price cap plan).

[9] As Ms. Zink testified, the Company is proposing to flow back to customers all merger-enabled gas costs savings from the BP Alliance (excluding only that portion of margins earned with respect to services that the Company is entitled to retain in accordance with the Department's policies adopted in Interruptible Transportation, D.P.U. 93-141 (1996)). Tr. 8, p. 971. The innovative gas portfolio optimization agreement at the heart of Berkshire's BP Alliance was approved by the Department in The Berkshire Gas Company, D.T.E. 01-41 (2001). The BP

3. The Department's Standard of Review.

The Department's standard of review for incentive ratemaking proposals such as Berkshire's PCM is well established:

> A petitioner seeking approval of an incentive proposal is required to demonstrate that its approach is more likely than current regulation to advance the Department's traditional goals of safe, reliable and least-cost energy service and to promote the objectives of economic efficiency, cost control, lower rates, and reduced administrative burden in regulation.

Boston Gas, D.P.U. 96-50 at pp. 242-243. Incentive Regulation, D.P.U. 94-158 at 57 (1995) ("Incentive Regulation" or "D.P.U. 94-158").

In addition to these general criteria, the Department has also established more specific criteria to be used in evaluating incentive proposals. Id. These criteria require that incentive proposals:

> (1) must comply with Department regulations, unless accompanied by a request for a specific waiver. The Department added that incentive proposals that comply with statutes and governing precedent are strongly preferred;
>
> (2) should be designed to serve as a vehicle to a more competitive environment and to improve the provision of monopoly services. Incentive proposals should avoid the cross-subsidization of competitive services by revenues derived from the provision of monopoly services;
>
> (3) may not result in reductions in safety, service reliability or existing standards of customer service;
>
> (4) must not focus excessively on cost recovery issues. If a proposal addresses a specific cost recovery issue, its proponent must demonstrate that these costs are exogenous to the company's operation;
>
> (5) should focus on comprehensive results. In general, broad-based proposals should satisfy this criterion more effectively than narrowly-targeted proposals;

Alliance allows the gas distribution subsidiaries of Energy East to pursue merger-enabled gas supply opportunities on a coordinated basis in order to secure savings for customers.

> (6) should be designed to achieve specific, measurable results. Proposals should identify, where appropriate, measurable performance indicators and targets that are not unduly subject to miscalculation or manipulation; and
>
> (7) should provide a more efficient regulatory approach, thus reducing regulatory and administrative costs. Proposals should present a timetable for program implementation and specify milestones and a program tracking and evaluation method.

Boston Gas, D.P.U. 96-50 at 243-245; Incentive Regulation at 58-64. As demonstrated in the testimony of the Company's nationally recognized independent expert, Dr. Gordon, the Company's PCM Plan is squarely consistent with each of these criteria. Exh. BG-3.

The following section II.B of this Initial Brief demonstrates, in detail, how each of the ten main elements of its PCM Plan: (1) cast off rates; 2) ten-year term; 3) 31-month rate freeze; 4) inflation adjustment; 5) enhanced productivity factor; 6) exogenous cost recovery; 7) mid-period review; 8) pricing and rate design flexibility; 9) rigorous service quality protections; and 10) streamlined and straightforward implementation), is appropriate and consistent with this well-established Department precedent, as well as Department precedent with respect to mergers and acquisitions.

B. The Specific Elements of the Company's Plan; Each of the Main Components of the Plan is Consistent with Department Precedent and Sound Ratemaking Policy.

1. Fair Cast Off Rates; the Cornerstone of the PCM Proposal.

The Department has consistently held that fair, compensatory cast off rates are an integral part of any alternative or incentive ratemaking plan. See Nynex Price Cap, D.P.U. 94-50 at 193-194; 90, n. 109 (1995) ("D.P.U. 94-50"); Boston Gas, D.P.U. 96-50 at 346-347 (1996). Relatedly, see Colonial Gas Company, D.T.E. 98-128 at 16-21 (1999).

As Mr. Allessio emphasized, Berkshire's PCM Plan can only be inaugurated confidently when it is built upon a solid and fair foundation. Exh. BG-1, p. at 20. As noted in section III of this brief, the record in this case establishes the Company's appropriate costs of providing safe and reliable service. Several points regarding these cost-based rates should be noted. First, as noted in section III, the Company has consistently applied established Department precedent in determining its revenue requirement for the start of the PCM Plan. It completed and presented a traditional cost of service analysis that was supplemented by expert testimony from Mr. Moul and Mr. Aikman. Second, the Company adjusted its cost of service analysis to establish the cost of service for Berkshire on a stand-alone basis, i.e., as an independent entity from EEC.[10] Any merger-related costs that were booked during the test year were removed and other appropriate adjustments have been made to the proposed revenue requirement. Exh. BG-22, p. 16. As indicated in Exh. AG 10-12, the bottom line of these adjustments is that the Company is not requesting that approximately $66 million of merger costs (acquisition premium and transaction costs) be included in (i.e., "pushed down" to) rates. From this fair, cost-based starting point, the PCM Plan will provide Berkshire with the opportunity to recover merger-related costs (through the retention of merger-enabled benefits) while also ensuring a guaranteed consumer dividend for Berkshire's customers, regardless of management performance. Tr. 8, pp. 945-946. This approach is consistent with and responsive to Department precedent and places Berkshire in a reasonably comparable position to other Massachusetts utilities that have been involved in

[10] See Colonial Gas Company/Eastern Enterprises, D.T.E. 98-128 (1999), where the Department approved Colonial's proposal to adjust its cast off rates to reflect a forecasted increase to its stand alone base rates in connection with the implementation of Colonial's 10-year rate plan in order to measure merger-enabled benefits.

merger transactions. Exh. BG-1, p. 21. See, Boston Gas Co. v. Department of Public Utilities, 367 Mass. 92, 104-105 (1975).

Just and reasonable cast off rates are also essential because the Department has long recognized that it is critical that distribution companies invest in their infrastructure to ensure continuing economic and reliable service. See, e.g., Investigation by the Department Pursuant to G.L. c. 159, §16 into the Practices, Equipment, Appliances and Service of Verizon-Massachusetts, D.T.E. 99-77, pp. 28-35 (1999); Vote to Open an Investigation by the Department on its Own Motion into the Service Quality of Boston Edison Company, et al. (August 24, 2001); Boston Gas Company, D.P.U. 96-30 at 31-32 (1997). The rates proposed in this case will enable Berkshire to continue such necessary investment. Exh. BG-1, p. 20. Conversely, without adequate cast off rates, the Company would be unable to commit to the aggressive ten-year price cap proposed in the PCM Plan.

In sum, Dr. Gordon's testimony is particularly helpful:

> The price-cap plan must begin from a reasonable starting point. The starting point must provide the utility with a reasonable opportunity to recover its costs (including the costs associated with the acquisition of Berkshire by Energy East to the extent that benefits are realized by customers). Any price-cap plan must begin from a starting point that balances the interests of the utility and its customers and therefore the outcome of the cost of service portion of this proceeding will play an important role by determining the starting point for Berkshire's PCM. If the starting point is set too low, the price-cap mechanism, as structured in the PCM, would provide little opportunity, if any, for the utility to actually earn its cost of capital—and this situation would likely not be corrected because the utility would not be able to file a rate case given the utility's commitment to stay out (except for certain specifically-designated items that would be addressed in the annual review proceedings).

Exh. BG-3, p. 1.

Accordingly, the Company requests that the Department approve the cast off rates proposed in this case and supported in detail by the testimony of the Company's cost of service witnesses. A detailed analysis of specific cost of service issues is provided in Section III, infra.

2. The Ten Year Term of the PCM Plan; Rate Stability for Customers and Consistency With Department Precedent.

The Department has found that "a well-designed price cap plan should be of sufficient duration to give the plan enough time to achieve its goals, and to provide utilities with the appropriate economic incentives and certainty to follow through with medium- and long-term strategic business decisions." Boston Gas, D.P.U. 96-50 at 320; see also Incentive Regulation, D.P.U. 94-158 at 66; NYNEX at 272. In order to comply with this precedent and provide significant rate stability benefits to customers, Berkshire is proposing a long-term price cap period of 10 years for the Plan. The Department has approved incentive ratemaking/price cap plans with terms of 10 years in several cases and Berkshire's PCM proposal builds upon this well-established precedent. See Eastern Enterprises/Essex County Gas Company, D.T.E. 98-27 (1998) (approval of a ten-year rate plan for Essex); Eastern Enterprises/Colonial Gas Company, D.T.E. 98-128 (1999) (approval of a ten-year rate plan for Colonial); New England Electric System/Eastern Utilities Associates, D.T.E. 99-47 (2000) (approval of a settlement that resulted in the approval of the proposed NEES/EUA merger and an associated 20-year rate plan; as part of the settlement, the DTE approved a rate plan that is comprised of three periods: (1) a five-year "distribution rate freeze period" (through February 28, 2005); (2) a five-year "rate index period" (March 1, 2005 through December 31, 2009); and (3) a 10-year "earned savings period").

Dr. Gordon testified that these examples show that rate plans with terms of 10 years can be successfully implemented in Massachusetts and that the Department should accept "the robust, durable and flexible plan proposed by Berkshire because it meets the needs of both utility customers and shareholders." Exh. BG-3, p. 20. In reaching this conclusion, Dr. Gordon emphasized that:

> [T]his assumes, of course, that the terms and conditions of the PCM, including the level and design of the rates that provide the starting point of the PCM, are set in a manner that allows Berkshire to agree to voluntarily "stay out" from filing a base rate case during the term of the plan. While the individual components of an alternative ratemaking plan must be appropriately specified, it is very important that the sum of individual components "add up" (i.e., are beneficial to utility customers). Berkshire's PCM, viewed as a comprehensive whole, does add up—and therefore a term of ten years is reasonable.

Id., p. 19.

Also, Berkshire emphasizes that the ten-year period (at a minimum) between comprehensive rate cases will help to reduce the direct administrative expense of rate regulation to the benefit of customers, the Department and the Company.

In sum, Berkshire's proposal of a ten-year term for the Plan provides important benefits for customers and the Company. For customers, the Company is voluntarily agreeing to refrain from base rate case filings for a **decade**; for the Company, the 10-year term gives it a meaningful and realistic opportunity to generate savings and pursue long term initiatives that will benefit shareholders.

3. Berkshire's Proposed Thirty-One-Month Rate Freeze; an Immediate Benefit for Customers.

Berkshire is voluntarily proposing to freeze its base rates for a 31-month period following the rate changes that will occur at the end of this rate case, i.e., until September 1, 2004. Term Sheet at p. 1. This base rate freeze will provide a real benefit to utility customers by guaranteeing that base rates will remain constant (in nominal dollars) during the rate freeze period, except in the limited event that Berkshire is required to seek a rate adjustment (plus or minus) due to any exogenous costs occurring during the 31-month rate freeze period. Exh. BG-22, pp. 9-10; Tr. 3, pp. 298-300.

This freeze provides immediate and significant benefits to customers, which they could not be guaranteed to receive absent Berkshire's voluntary offer to not file a rate case if the PCM is approved. As Dr. Gordon testified: "Given the general upward trend in price levels over time, this a real risk for utility shareholders to take on." Exh. BG-3, p. 21. Berkshire notes that, in the context of other long term rate plans, the Department has favored the concept of initial rate freezes, and Berkshire's proposal is consistent with such precedent. See, e.g., New England Electric System/Eastern Utilities Associates, D.T.E. 99-47 (2000).

4. **Berkshire's Inflation Index Proposal is Consistent with Department Precedent and Sound Policy.**

Berkshire proposes to utilize the Gross Domestic Product chain weighted Price Index (GDP-PI) in its PCM in order to adjust rates after the initial 31-month rate freeze. As Dr. Gordon testified, use of an inflation factor in a long-term plan "simply allows the maximum rates under the plan to move in a reasonably cost-based way during the time the incentive plan is in place." Exh. BG-3, p. 18. The chain-weighted GDP-PI index is typically used in price-cap plans, including in Massachusetts. Indeed, the GDP-PI is the primary inflation index maintained by the Bureau of Labor Statistics, is almost universally used in United States telecom price cap plans, has been employed in Massachusetts PBR plans, and is widely seen as a good gauge of overall inflation. Exh. BG-3, p. 21; see also NYNEX, D.P.U. 94-50 at 141; Boston Gas, D.P.U. 96-50 at 273. Notably, the Attorney General supports the use of the GDP-PI if an inflation adjustment is allowed in the Company's PCM. AG In. Br., p. 13.

As Ms. Zink testified, the Company chose to "use the GDP-PI based upon the Department's findings that:

> GDP-PI is (1) the most accurate and relevant measure of the output price changes for the bundle of goods and services whose [total factor productivity] growth is measured by the Bureau of Labor Statistics, (2) readily available, (3) more stable than other inflation measures, and, (4) maintained on a timely basis.

Exh. BG-22, pp. 11-12 quoting Boston Gas Company, D.P.U. 96-50 at 273.

The ability for the Company to adjust its rates based upon inflation is an essential element in allowing it to propose a 10-year price cap. If the Company were not able to ensure reasonable protection against spikes in costs beyond its control, it would not be able to offer the benefit of a 10-year plan to customers.

5. The Company's Enhanced Productivity Factor Guarantees that Customers Enjoy an Annual 1% Dividend.

In its PCM formula, Berkshire is proposing that an enhanced productivity factor be employed. Term Sheet, p. 2. Specifically, through the enhanced productivity offset, the Company returns to customers an annual enhanced productivity dividend through a 1% annual base rate **decrease**, regardless of whether the Company's management has actually been able to reduce costs. (Such decrease is applied as an offset to the GDP-PI factor, so that, in the event inflation is greater than 1%, any annual rate increase would be 1% lower than it otherwise would have been and, in the event inflation is less than 1%, base rates would decrease in both nominal and real terms.) This enhanced productivity factor ensures, at the least, that customer prices will **decline** in real terms during the term of Berkshire's plan, excepting only any possible exogenous cost recovery. Exh. BG-22, p. 12.

As a policy matter, Dr. Gordon testified that a productivity factor can include two components. First, the base productivity component of the factor is a target chosen to reflect the industry-benchmark productivity growth potential of the regulated firm over the forward-looking term of the plan.[11] "In some plans, an additional amount is added to the [base] productivity offset—often referred to as a "consumer dividend"—in order to provide an additional assurance that consumers will benefit from the plan." Exh. BG-3, p. 22. Berkshire has elected this additional enhancement to its PCM in order to ensure that its customers enjoy even more significant benefits from the Plan than would be the case if it only utilized a base productivity component.

With respect to the first component of this factor, Berkshire concluded, after consultation with NERA, that the high costs of undertaking a new base productivity offset study (which could cost up to $500,000) were clearly outweighed by the limited benefits of doing so, mainly because of Berkshire's small size. Exh. DTE 2-4; Exh. DTE 1-58; Exh. BG-3, pp. 22-23; Exh. BG-22, pp. 12-13. Rather, Berkshire conservatively applied the precedent from Boston Gas, D.P.U. 96-50, where the Department concluded, based on the extensive expert evidence presented, that the productivity offset factor was essentially zero for the gas industry. Id. at p. 282. Exh. BG-3, pp. 22-23; Exh. BG-22, p. 12.[12] This decision is also consistent with Department policy requiring

[11] As Dr. Gordon testified, the productivity offset is the "mechanism by which customers receive the benefit of the regulated firm's expected productivity growth over and above the average productivity growth of firms in the United States economy. . . . In an industry [such as the natural gas distribution industry] where the expected rate of productivity growth was the same as that of the economy as a whole, the base productivity offset would be zero." Exh. BG-3, p. 7.

[12] Specifically, as part of its PBR proceeding (D.P.U. 96-50, Phase I), Boston Gas commissioned a study of gas distribution total factor productivity ("TFP") for 51 gas LDCs, 19 of which were located in the northeastern U.S. Boston Gas, D.P.U. 96-50 at p. 262). Such studies were, appropriately, based on the longest time series for which there is sufficient data

that utilities must "strike some balance between accuracy and cost" with respect to decisions to undertake quantitative studies. See Boston Gas Company, D.P.U. 94-14 (1995) (utility not required to conduct certain costly DSM "impact evaluations"). See Tr. 3, p. 285. Berkshire's decision also reflected the Department's findings in Eastern Enterprises/Colonial Gas Company, D.P.U. 98-128 (1999) that "because productivity offsets are not company-specific, it is appropriate to use a productivity offset developed for another LDC for the purpose of this case. Therefore, the Department finds it reasonable to use the same productivity offset implemented for Boston Gas." Id. at 63-65.

Indeed, Dr. Gordon testified that, if the Company were to undertake an independent productivity study, "after all that time, effort and money, the result would likely be very little change to the base productivity offset determined in the Boston Gas proceeding. The likely net effect would be that neither consumers nor the company would benefit, as the costs of the study would likely offset any increase (or decrease) in the base productivity offset. Indeed, assuming that the regulatory costs of calculating the base productivity offset are recoverable from utility customers and that the base productivity were to go down, then consumers would lose twice." Exh. BG-3, p. 23.[13] For these reasons the Department should reject the Attorney General's complaint that the Company should have undertaken a costly new productivity study.

---

available to perform the computations. As Dr. Gordon testified, were Berkshire Gas to perform its own TFP study, it would at most add some small number of years to the end of that data series. Exh. BG-3, p. 22.

[13] As Dr. Gordon stated in Exh. DTE 1-58: "Updating the Boston Gas study would be a major undertaking. While I am aware, for example, that data relating to U.S. productivity growth during the mid-1990 period may now be available for analysis, I am not aware of any differential productivity growth trends in the natural gas distribution industry relative to the U.S. as a whole. Thus, I see no reason at this time to update the "Boston Gas" productivity study. Nor do I have an independent reason to think that productivity in gas distribution is now growing measurably faster (or slower) than that of the economy as a whole or that input prices for the two are now

After determining that the base productivity portion of the productivity factor was zero, the Company elected to add a second component to the factor: a 1% guaranteed annual consumer dividend. See Exh. DTE 1-54. As Ms. Zink testified, the 1% consumer dividend:

> [I]s an aggressive target for Berkshire in that the Company will have to achieve more than a quarter million dollars per year in productivity gains based on its distribution revenue requirements. Further, our management has operated under a de facto base rate cap since 1993 which is a much longer period than many Massachusetts utilities that have price cap plans. Moreover, the PCM Plans does not reflect known major capital commitments such as the need for additional LNG tanks. However, this large consumer dividend, in conjunction with the 31-month rate freeze, will ensure benefits to Berkshire's customers over the long-term. Finally, in addition to the price freeze and consumer dividend, it should be noted that Berkshire's customers will also benefit substantially from merger-enabled gas cost savings, a factor considered in establishing the consumer dividend.

Exh. BG-23, pp. 12-13.

Dr. Gordon testified that, the selection of an appropriate consumer dividend is necessarily somewhat judgmental and that Berkshire's specific proposal was appropriate:

> This [1.0 percent] consumer dividend appears to me to be more than adequate, and will put substantial pressure on Berkshire to increase its efficiency and enhance its revenues. Given the substantial efforts that Berkshire has made during the over eight year period during which it operated under a de facto base rate freeze, I doubt whether Berkshire would be able to provide a consumer dividend of this magnitude if the acquisition of Berkshire by Energy East, with its accompanying new opportunities for efficiencies, had not been completed. As such, this consumer dividend provides a strong assurance that Berkshire's customers will be better off as a result of the merger and approval of PCM. . . . [I]n this case, the large consumer dividend proposed by Berkshire (in conjunction with the 31-month initial rate freeze) can assure stakeholders that a substantial—and concrete—benefit to consumers will result from Berkshire's PCM.

Exh. BG-3, p. 24.

---

growing at significantly different rates." Dr. Gordon also testified that: "the appropriate analysis is the added costs (which given full regulatory review could cost $500,000 in just consultant costs (Tr. 1, p. 140)) do not justify the minimal value, if any, added to the regulatory process." Tr. 1, p. 47. See also Exh. DTE 2-4.

Dr. Gordon also emphasized that the one percent figure is consistent with the factors ultimately applied in Boston Gas, D.P.U. 96-50 and is a particularly aggressive factor given that Berkshire has operated under a de facto base rate freeze for a period of over eight years. In responding to cross examination, Dr. Gordon stated:

> [A] standard application of pure theory of price caps would simply be a . . . reduction of the inflation increase by the amount of productivity growth, which in this case I believe it is reasonable to estimate at zero. That would amount to a price cap that moves up at the rate of inflation, and that's it, except for exogenous factors. Here the company has put forth a stretch factor, 1 percent. Whether you think about it as a consumer dividend, whether in your own mind you're thinking of it as accumulated inefficiencies or whatever, a subject which I understand is still under discussion in Massachusetts with respect to Boston Gas, the sum and substance of it, it comes up to about 1 percent, which is also comparable to where I believe Boston Gas is at the moment, although labeled somewhat differently than this. In the case of Boston Gas it's labeled accumulated inefficiencies, a half a percent -- subject to appeal, I gather -- and half a percent for consumer dividend. But however you slice it, it's 1 percent for consumers. So I think that's pretty good. (Tr. 1, pp. 70-71). . . . I say given that the company, Berkshire, had operated under a rate freeze, what was obviously a de facto -- not, obviously, a de jure, but a de facto -- rate freeze, for some time. And I would also, in circumstances where -- I guess I wouldn't describe them as vibrant in terms of the economy they operate in, where their earnings, return on equity has typically been over that period -- there's certainly been some financial pressure on the company to cut costs, to become more efficient. The employee count over that period reflects that effort to some degree. So . . . there probably isn't as good an argument here for accumulated inefficiencies to be a significant factor as there might have been back in the mid-'90s or some earlier point in time for some other utilities. If that's the case, then the 1 percent is mostly "consumer dividend," quote-unquote, and probably not very much accumulated inefficiency, and in that sense it's above what the Department settled on for Boston Gas. This is obviously a judgmental area, and I don't seek to pretend that it is otherwise. But it seems to accord with where the Department has been coming from on these issues.

Tr. 1, pp. 130-131.

Ms. Zink's testimony on this matter directly comports with that of Dr. Gordon:

> The way that the 1 percent consumer dividend was generated could include accumulated inefficiencies, although probably very small in Berkshire's case. We've been out of a rate case for almost nine years and have essentially worked under a de facto base-rate freeze for the last nine years. So most of those

> inefficiencies have probably gone away, in the sense that the Company has become more efficient in the last nine years, to be able to stay out of a rate case.
>
> There could be a very small piece in that consumer dividend that relates to accumulated inefficiencies. But in total, whether it's .1, .2, whatever the case may be, it's consistent with what we looked at in the Boston Gas case, 96-50, which had a consumer dividend of a half a percent and accumulated inefficiencies of a half a percent, which in total was 1 percent. And we were consistent with that 1 percent in total.

Tr. 3, pp. 283-284.

With specific respect to the Department's findings in Boston Gas, D.T.E. 96-50, the Company notes that, following Boston Gas' motion for reconsideration, the Department established a consumer dividend factor for inclusion in the productivity offset of 0.5%. See Boston Gas Company, D.P.U. 96-50-C (Phase I) (May 16, 1997) at p. 58. In the Department's January 16, 2001 order in Boston Gas Company, D.T.E. 96-50-D, the Department established that "the accumulated inefficiencies factor be 0.5% for the remainder of Boston Gas' current PBR term period." Id. at 13. Accordingly, the net result of the Department's intensive investigation in docket D.T.E. 96-50, based upon extensive expert evidence, approved an "enhanced" productivity offset consisting of a 0.5% consumer dividend and a 0.5% accumulated inefficiencies factor, totaling a 1% factor. The Company's proposal is consistent with this precedent and, given that, as Ms. Zink and Dr. Gordon testified, there are likely minimal accumulated inefficiencies for Berkshire, Berkshire's proposal clearly provides benefits for customers and represents an honest "stretch" for the Company. Tr. 1, pp. 130-131; Exh. BG-3, pp. 7, 24.

In sum, Berkshire's enhanced productivity factor (reflecting a base productivity factor of zero, enhanced by means of a guaranteed 1% customer dividend) is supported by Department precedent and sound economic policy. This factor is also strongly supported in the highly credible testimony of Dr. Gordon. The ultimate beneficiaries of this proposal are the Company's customers who, beginning September 1, 2004, will receive an annual guaranteed 1% consumer dividend in base rates for the remaining term of the Plan.

6. **The Company's Exogenous Costs Proposal is Reasonable and in Accordance with Department Standards.**

The Department has defined exogenous costs as positive or negative cost changes beyond a company's control that would significantly affect the company's operations. Eastern-Colonial Acquisition, D.T.E. 98-128 at 55 (1999); NIPSCO-Bay State Acquisition, D.T.E. 98-31 at 18 (1998); Eastern-Essex Acquisition, D.T.E. 98-27 at 19 (1998). In virtually every price cap/incentive ratemaking proposal approved in Massachusetts, the Department has allowed the utility the opportunity to recover exogenous costs that could materially affect its ability to earn its allowed rate of return.[14] Id. As Dr. Gordon testified, because these costs "are not under the control of the firm, automatically passing such cost changes through to customers does not affect the incentive of the firm to behave efficiently. Adjustments to the price cap index (positive or negative) to pass through cost changes due to exogenous events are a theoretically sound and well-recognized component of price cap plans." Exh. BG-3, p. 25. In essence, exogenous cost recovery is one of the core items of the PCM that allows Berkshire to provide benefits to customers by agreeing to refrain from filing a base rate case request for a decade and, beyond that, by guaranteeing an annual 1% consumer dividend to customers after a 31-month rate freeze.

---

[14] See *e.g.* Boston Edison et al, D.T.E. 99-19 (1999) (allowing for exogenous cost adjustments during four year rate plan); Colonial Gas Company/Eastern Enterprises, D.T.E. 98-128 (1999) (exogenous cost adjustments allowed during ten year rate plan); Bay State Gas Company/Northern Indiana Public Service Company, D.T.E. 98-31 (1998) (five year rate plan subject to changes for exogenous factors); Essex County Gas Company/Eastern Enterprises, D.T.E. 98-27 (1998) (ten year rate plan subject to changes for exogenous factors).

As Ms. Zink testified: "under Berkshire's proposed PCM, only certain limited costs would be eligible for exogenous cost recovery and then only if they total $50,000 in the aggregate, with individual exogenous cost items included only if they total at least $10,000." Exh. BG-22, p. 14; see also Exh. BG-3, p. 25.[15] Berkshire would be able to ask for recovery of exogenous costs during the 31-month rate freeze period, as well as the remaining price-cap period of the PCM. Term Sheet, p. 3.

The specific costs that would be eligible for exogenous treatment under Berkshire's Plan are detailed in the Term Sheet as follows:

> A cost must meet each of the following criteria to be considered an exogenous cost:
>
> 1. Be beyond the control of the Company.
>
> 2. Have at least a disproportionate effect on the Company or the natural gas distribution utility industry and not be adequately accounted for in the price index.
>
> Costs that would be eligible for exogenous cost treatment would include:
>
> 1. Accounting, legislative, regulatory, or tax changes;
>
> 2. An "Act of God" (*force majeure*).
>
> Changes in laws or regulation, which would be eligible for exogenous cost recovery, would include but are not limited to changes in revenue or cost resulting from changes in demand-side management policy. In addition, to the extent that lost base revenues ("LBR")[16] not recovered pursuant to the LDAC exceed the threshold described above, an Exogenous Cost adjustment will be permitted for the amount such lost base revenues exceed the threshold.

Term Sheet at p. 3.

---

[15] As set forth in Exh. DTE 5-9, the Company and NERA developed the $10,000 individual item threshold "based on a judgment that asking for exogenous cost recovery of several exogenous cost items totalling $50,000 was appropriate but that each of the items must have a material impact on the Company." Id.

As indicated above, under Berkshire's proposal, exogenous factors that have economy-wide effects are likely to be reflected in the inflation measure and the productivity offset, and Berkshire proposes to limit exogenous cost recovery only to those events that disproportionately affect a utility or the utility industry--as opposed to the entire economy. Exh. BG-3, p. 25. Berkshire's proposal with respect to exogenous cost treatment for LBR issues is squarely consistent with recent Department directives and is discussed in further detail in Section II. F.1 infra. See Bay State Gas Company, D.T.E. 00-106 (Letter Order of March 30, 2001) (LDCs seeking recoupment regarding LBR should make exogenous cost filings).[17]

As set forth in Exh. DOER 1-8, in establishing the $50,000 aggregate threshold for exogenous cost recovery, the Company reviewed the thresholds approved by the Department for other companies, as well as the thresholds approved for other Energy East LDC subsidiaries.[18] Exh. DOER 1-8 shows that the $50,000 threshold used in Berkshire Gas's PCM is generally consistent with those supported by Dr. Gordon for Connecticut Natural Gas and Southern Connecticut Natural Gas. The exhibit also demonstrates that the $50,000 threshold is also **more** demanding than that used in Boston Gas, D.P.U. 96-50; based on a comparison to Boston Gas,

---

[16] LBR or lost margins are defined as the non-gas-cost portion of a gas utility's base rate that is lost between rate cases as a result of reduced sales caused by the implementation of demand side management, or DSM programs." Boston Gas Company, D.P.U. 90-17/18/55, at 139 (1990).

[17] The Term Sheet also allows the Company to defer certain costs in accordance with existing accounting principles. Id., at 5. As set forth in Exh. DOER 1-25, "Berkshire would have the same opportunity to ask for an accounting order that allows for deferral of costs as it does under traditional regulation. During annual review proceedings, costs that had been deferred could be recovered in rates under the exogenous cost mechanism, if otherwise eligible under the terms of the Plan."

[18] The Department has stated that there should be a threshold for qualification as an exogenous cost in order to avoid costly regulatory process over minimal dollars. Eastern-Colonial Acquisition, D.T.E. 98-128 at 55 (1999); NIPSCO-Bay State Acquisition, D.T.E. 98-31 at 18 (1998); Boston Gas Company, D.P.U. 96-50 at 288-290 (1996); NIPSCO-Bay State Acquisition, D.T.E. 98-31 at 18 (1998); Boston Gas, D.P.U. 96-50 at 288-290 (1996).

D.P.U. 96-50, the exogenous cost threshold for Berkshire Gas would only need to be about $39,000 Id. Using Colonial Gas as a comparison, (using revenue data for 1999 and 2000), the exogenous cost threshold for Berkshire would be about $65,000. Id. This threshold assures that exogenous cost recovery is involved only for material events and cannot repeatedly be used as a "make whole" device by the Company. In sum, Berkshire's exogenous cost recovery proposal is firmly supported by Department precedent and is essential to enabling the Company's aggressive 10-year commitment to refrain from filing for base rate increases.

7. Berkshire is Proposing a Mid-Period Review to Enhance the Stability of the PCM Plan.

As explained in the Terms and Conditions, in order to enhance the long-term stability of the PCM, following the completion of the fifth year of the Plan, on April 1, 2007, the Company will file information with the Department on the performance of the PCM. As set forth in Exh. DTE-RR-4, during this mid-period review, the PCM would be considered as, and presumed to be, a ten-year plan and its terms would enjoy the presumption of correctness. Tr. 8, pp. 951-952. The Plan will continue for its full 10-year term (to January 31, 2012) unless the Department determines in the mid-period review that continuing the plan for 10 years is harmful to utility customers. In that case, the Plan would terminate following the seventh year of the Plan (at January 31, 2009).

As described by Dr. Gordon and set forth in Exh. DTE-RR-4, given the 31-month rate freeze, a mid-term review following year five provides sufficient and early opportunity to review the performance of the PCM Plan after it has been in place for several years. By starting the review after the fifth year, adequate time is available to accommodate any review and provide an opportunity for a transition to an alternative rate plan, if necessary.[19] As Dr. Gordon testified, in order to provide the full incentives of a plan with a 10-year term, the PCM must be expected to continue in effect for its full term. Exh. DTE 1-60; Tr. 1, p. 146; Exh. BG-3, pp. 26-27. Thus, the Company, working with NERA, has proposed that the standard for any early termination of the Plan be high, e.g., the Berkshire PCM should only be ended at year seven if it is clearly shown in the mid-period review that: (1) customers would be clearly and substantially harmed by continuation of the Plan; and (2) Berkshire's rates, in aggregate for the duration of the Plan, are clearly not just and reasonable. Exh. DTE-RR-4. Under the Company's proposal, as long as the operation of the PCM Plan as a whole is securing benefits for customers and shareholders, then continuation of the Plan through the full ten-year term would be in the public interest. Id.

In the mid-period review as proposed by the Company, the Department would evaluate the Plan in its entirety and not focus exclusively on any particular feature of the PCM. Id. As Dr. Gordon emphasizes, the mid-period review should not be viewed as an opportunity to modify or recontract the PCM Plan. Exh. BG-3, pp. 26-27. In any event, the Plan will not preclude Department review under a §93 petition, but any such review would be consistent with the standards articulated in Essex County Gas Company, D.T.E. 98-27 at 13-14 (1998). Such standards expressly contemplate that any §93 review during the term of a rate plan "must account for costs incurred by the Petitioners in consummating the merger in reliance on this

[19] Dr. Gordon testified: "Now, why five years? Well, the obvious answer is: the middle. It still leaves you time to conduct your review and do something about it in year seven, which means you can cut the process off three years early, and that's a third of what was planned, almost a third of what was planned. So it gives you time to get in and do something that has a real consequence. Yet keeping it till seven. . . goes partway for the Company toward meeting the initial expectation. Again, it's a balancing and a judgment, but it was an attempt to give [the Department] comfort that [it has] a way of short-circuiting this if absolutely necessary. It's important to note that only the Department can do that." Tr. 1, pp. 146-147.

Order and for the opportunity, explicitly recognized by this Order, accorded to Petitioners to recoup those costs." Id. Also, in the mid-period review, the mere fact that the Company may have earned more than its target rate of return in a given year would not be a reason to terminate the Plan. Tr. 2, p. 252. This proposal is in accordance with the Department's policy that: "Any definition of reasonable compensation under an incentive regulatory scheme must be broad enough to allow a utility that is achieving above-average efficiencies to earn more than has been defined as a 'fair return' under ROR regulation. In this sense, a reasonable return under ROR regulation is not the same as what would be considered a reasonable return under price cap regulation." NYNEX, D.P.U. 94-50 at 192.

The Company emphasizes that its mid-period review is based upon currently reasonably foreseeable future scenarios. As Mr. Allessio testified, in the event the Company were faced with significant, "catastrophic" matters not currently foreseen, of course, the Company would "support getting the relevant parties together and working out a course of action." Tr. 2, p. 251. In the event of the termination of the Plan in the event of catastrophic circumstances -- a highly unlikely event that the Company does not foresee -- the Company would need to reserve its right to propose an alternative mechanism to recover merger-related costs consistent with the Department's current recovery standards.

As Dr. Gordon and Ms. Zink testified, while price-cap plans sometimes include a profit-sharing component, Berkshire's "second generation" PCM does not.[20] Dr. Gordon testified that:

---

[20] As set forth in Dr. Gordon's testimony, if the Department were to mandate a profit sharing mechanism, the Boston Gas approach, which includes a wide dead zone, should be used. In D.P.U. 96-50, Phase I, an earnings-sharing plan with a 400 basis point bandwidth on either side of the authorized ROE of 11.00 percent (a total bandwidth of 800 basis points) was adopted.

> While profit sharing can increase the stability of the plan by allowing consumers to share in the benefits and costs of extremely good or bad performance, profit sharing reduces the utility's efficiency incentives, by reducing a firms' ability to appropriate the net receipts associated with its efforts and decisions.[21] The "cost" of earnings sharing is that, to the extent sharing is in effect (i.e., outside the dead band), it dampens the incentives of a company to innovate to increase its efficiency. The tradeoff between pure price caps and a price cap that includes profit sharing is clear: efficiency incentives are given up in return for a more stable regulatory regime—but that stable regime can then provide a net improvement in efficiency incentives (by decreasing the risk of unplanned recontracting). Given the innovative mid-period review proposal, I believe that an earnings sharing mechanism is therefore neither necessary nor appropriate.

Exh. BG-3, p. 27.

Also, as Ms. Zink testified, earnings sharing creates an additional administrative burden for all parties. Exh. BG-22, p. 14.[22] The Company emphasizes that in the current case, where Berkshire is willing to forego pushing its merger costs into base rates in return for the opportunity to benefit from merger-enabled savings, it is especially crucial that earnings sharing not be a required component of the PCM in order to allow a reasonable opportunity to recover these costs. See generally Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923); Federal Power Commission v. Hope

---

Downside sharing below 7.00 percent is split 75 percent/25 percent between shareholders and ratepayers, respectively. Upside sharing above 15.00 percent is split 75 percent/25 percent between shareholders and ratepayers, respectively. D.P.U. 96-50 at 324; Exh. BG-3, p. 27, n. 14.

[21] Dr. Gordon testified that in telecommunications, price cap plans that have been established in recent years rarely include profit sharing provisions. Exh. BG-3, p. 27, n. 15.

[22] Dr. Gordon also testified: "[a] mid-period review adds to the stability of a price-cap plan by providing an opportunity to review the past and expected future performance of the plan, thereby providing an opportunity to determine whether the price-cap mechanism is providing benefits to utility customers. Earnings sharing builds into a price-cap mechanism a semi-automatic sharing of the benefits/costs of extremely good or extremely poor financial performance by the Company. Earnings sharing thus helps to provide stability but also would dampen the utility's incentives. In designing a mid-period review, the challenge is to develop an approach that provides a reasonable assurance that the plan will continue to run for a meaningful period of time, unless something is seriously amiss. In this fashion, a mid-period review can add to the stability of a price-cap mechanism." Exh. DTE 1-60.

Natural Gas Co., 320 U.S. 591 (1942); see also Fitchburg Gas & Electric Light Company, D.T.E. 99-118 (2001), pp. 78-79. In this regard, the Company's proposal not to require earnings/downside sharing is consistent with the Department's policy that "a well-designed incentive plan should provide a utility with the opportunity to earn greater rewards in exchange for the assumption of greater risk." Boston Gas, D.P.U. 96-50 at 243. The Company's proposal is also consistent with the Department's rejection of earnings sharing in Northern Indiana Public Service Company/Bay State Gas Company, D.T.E. 98-31 at 23-24 (1998).

In sum, Berkshire's proposed mid-period review adds to the stability of a price-cap plan by providing an opportunity to review the past and expected future performance of the Plan, thereby providing an opportunity to determine whether the price-cap mechanism is providing benefits to utility customers. It also avoids the need for earnings sharing. As Dr. Gordon candidly testified:

> [The mid-period review is] an attempt to make the Department a little more comfortable, hopefully make other intervenors a little more comfortable, with this, because it wouldn't be locked in. That comes at some cost, because the review could have some negative impact on the incentives, and so it gives me pause. It probably may give me a little more pause than the Company, actually. But the Company felt that comfort was a good thing to have, and I don't object to it strongly. So there it is.

Tr. 1, p. 146.

Based on the foregoing, the Company requests that the Department approve its proposed mid-period review.

8. **Berkshire's PCM Contains Pricing Flexibility and Rate Design Component's Designed to Allow it to Meet the Department's Ratemaking Goals.**

Berkshire's PCM Term Sheet provides for rate design and pricing flexibility in order to achieve the Department's ratemaking policy goals as follows:

> **Rate Design**
>
> The overall [annual] price change percentage will be applied to the revenue in each core rate class to determine the total revenue change for each core rate class. Berkshire shall be authorized to allocate the particular price cap increase or decrease within a class at its discretion so long as no rate component increases by more than the rate of inflation (Boston Gas, D.P.U. 96-50, p. 332). If the price increase is greater than the rate of inflation, because of the recovery of Exogenous Costs, the Company would increase each rate component at no more than the rate provided by the price-cap formula. Berkshire shall seek to move its distribution rates closer to equalized rates of return, but the limitation just described ensures that, absent Exogenous Cost recovery, no individual rate component shall increase by greater than the rate of inflation during the term of the [P]lan. . . .
>
> **Pricing Flexibility**
>
> Berkshire will have the option to offer negotiated pricing and service offerings for large, non-residential customers using over 60,000 therms annually effective upon filing with the Department so long as such contract is for a term that does not extend beyond the term of this [P]lan and the contract price exceeds the relevant marginal cost floor price.

Term Sheet, p. 4.

As both Ms. Zink and Dr. Gordon testified regarding rate design flexibility, rather than requiring across-the-board increases as part of any annual rate changes, the Company is best served by being able to selectively alter rate changes within classes so that prices move to a more cost-based rate design and equalized rates of return in accordance with Department precedent. Exh. BG-22, pp. 10-11; Exh. BG-3, pp. 27-28; Tr. 1, pp. 73-74. In order to provide for rate continuity and stability, however, absent exogenous costs, no rate component would be allowed to increase by more than the rate of inflation applied to the particular year's price adjustments.

Exh. BG-22, p. 10.[23] This approach balances important rate design considerations in a reasonable way and allows Berkshire's rate design gradually to adjust, based on proper rate design principles, over the term of the Plan. Id. pp. 10-11. It is important to note that, as Mr. Normand's testimony demonstrates, absent some pricing flexibility, the Company is severely constrained in its efforts to move toward equalized rates of return. See e.g., Exh. BG-15, p. 24. Indeed, without the flexibility provided in the Plan, relative rates of return for rate classes would be expected to be severely out of alignment at the expiration of the Plan. Among many other benefits, a long-term PCM period permits the kind of gradual adjustments to rates that are needed to make them more cost based by the end of the Plan's term.

With respect to pricing flexibility, as Ms. Zink testified, the Company is proposing that it will have the option to offer negotiated pricing and service offerings for large, non-residential customers using over 60,000 therms upon filing with the Department so long as the customer contract does not extend beyond the term of the Plan and the contract price exceeds the relevant marginal cost floor price. Exh. BG-22, p. 15; Tr. 1, pp. 72-74. The Company requires this pricing flexibility because, without this ability, its largest customers could opt to switch to an alternate fuel and avoid taking firm service from the Company, thus resulting in higher rates for remaining customers. Id.; Exh. BG-3, pp. 27-28. In a worst case scenario, these larger customers could attempt to bypass the Company's system entirely. Large customer loss is a major threat to Berkshire which would adversely affect remaining customers. Exh. BG-22, p. 10. The pricing flexibility terms of the PCM play a key role in allowing Berkshire to retain (or attract) customers that have competitive options; by retaining (or attracting) these customers, Berkshire will be able

---

[23] As set forth in DTE-RR-52(a), the Company is willing to adopt alternative limits to its rate design flexibility whereby it would "cap the level of the overall rate specific adjustment to 1.25

to spread the fixed costs of its operations over a larger customer revenue base thereby reducing costs for the benefit of all customers. Importantly, as Ms. Zink and Dr. Gordon testified, any discounts to qualifying large customers will be borne by the Company and not subsidized by other customers during the term of the Plan. See e.g., Tr. 8, p. 924.

Lastly, Berkshire emphasizes that its rate design and pricing flexibility proposals are squarely consistent with Department precedent. See e.g., Boston Gas, D.P.U. 96-50, where the Department stated:

> The Department agrees with the Company that it should retain some discretion in allocating the price cap increase between rate elements within a class. Allowing Boston Gas to set the rate component charges within a class should help to reduce intraclass subsidies and high bill impacts for individual customers. . . . The Department finds that. . . the Company [is allowed] to allocate the price cap increase or decrease within a class at its discretion as long as no rate component increases by more than the rate of inflation. . . . Should the price cap increase be greater than the rate of inflation, because of the recovery of exogenous costs, the Department directs the Company to increase each rate component price at no more than the rate provided for in the price cap formula.

Id. at pp. 333-334. Berkshire's rate design and pricing flexibility proposals in this case are entirely consistent with each of these findings of the Department.

9. Service Quality; Berkshire Proposes to Implement Fully the Rigorous Standards Adopted in D.T.E. 99-84.

The Department has required that any utility proposing an incentive ratemaking proposal must ensure that its plan will "not result in reductions in safety, service reliability or existing standards of customer service." Boston Gas, D.P.U. 96-50, at 243; see also Incentive Regulation at 58-64; see also Eastern/Essex Acquisition, D.T.E. 98-27 at 32 (1998). Berkshire is very focused on the Department's service quality requirements and is acutely aware that the

---

times the overall adjustment" in order to address rate continuity concerns. Id.

Department is requiring that all LDCs to adopt rigorous service quality standards. As detailed below, Berkshire is totally embracing these requirements in its PCM Plan.

Berkshire filed its PCM plan on July 17, 2001. The PCM Terms and Conditions filed on such date expressly provided that the Company would comply with the rigorous service quality standards just adopted in the then very recent (June 29, 2001) final decision in D.T.E. 99-84. Specifically, in order to ensure comprehensive compliance, the Company stated that it would supplement its filing in order to provide the detailed information necessary to comply with the Guidelines established in D.T.E. 99-84. These materials were filed by the Company during the proceedings and was marked as Exh. DOER 1-4.

As noted in Exh. DOER 1-4, the Company has already established benchmarks for four of the seven specific measures set forth in the Department's D.T.E. 99-84 Guidelines: 1) consumer division cases; 2) billing adjustments; 3) response to odor calls; and 4) lost work time accident rate.[24] For the remaining three measures: 1) telephone service factor; 2) service appointments met; and 3) on-cycle meter readings, where three years of valid and consistent historical data is not yet available, the Company is proposing to establish benchmarks as soon as three full years of data are available, all in accordance with the Company's understanding of the Department's directives in D.T.E. 99-84. Id; Guidelines at § I.C. This information is summarized in the following table from Exh. DOER 3-1.

[24] With respect to the response to odor call measure, the Company understands that three years of history is not required, but rather that it must respond immediately at least 95% of the time or a penalty will be issued.

Berkshire Gas Company Service Quality Standards

Service Quality Indice	Penalty Percentage	Penalty Offsets	Min. 3 Year Historic Data Available	Date Min 3 Year Historic Data Available	Historic * Average	Standard * Deviation
Meter Reading	10	Yes	No	1-Jan-03		
Lost Time Accidents	10	Yes	Yes		10.74	2.82
Response to Leak/Odor Calls	45	Yes	N/A		N/A	N/A
Consumer Cases	5	Yes	Yes		54.20	16.12
Billing Adjustments per 1000 customers	5	Yes	Yes		$110.75	$105.40
Service Appointments	12.5	Yes	No	1-Jan-05		
Telephone Response Time	12.5	Yes	No	1-Jan-04		

* Based on data through 2000 (2001 not included)
Historic Data will be added each year until 10 years are available
Offsets can be unilaterally applied to all SQI's except for deficient response to leak/odor calls.
Customer service guarantees that are paid will be deducted from maximun penalty (2% of annual T & D revenues)
Historic Average and Standard Deviation will be updated in January 2002

Berkshire notes that it responded to three record requests of the Department (Record Requests DTE-RR-5, DTE-RR-6 and DTE-RR-7) with respect to the historical data for the three measures for which three years of historical data are not yet currently available. These responses provided all available information on these measures, some of which was merely proxy data developed by the Company. While, consistent with the order in D.T.E. 99-84, the Company does not propose to implement standards for these three measures until adequate data is collected, in the event that the Department prefers to impose interim standards for such measures, the Company has, in good faith, provided as much data as it possesses in order to inform any such decision by the Department.

With respect to the mechanics of implementing the generic Guidelines, as set forth in Exh. DOER 1-4, the Company proposes to implement the relevant service quality standards during the term of the Plan on an annual basis consistent with the Guidelines. The Company proposes to update periodically its service quality standards to incorporate each of the remaining three measures as soon as sufficient data has been compiled. Id. Berkshire proposes to make filings on March 1 of each year based upon calendar year-end data consistent with the requirements of the Guidelines and G.L. c. 164, §1E. Such new standards would be incorporated into the annual filings proposed for the PCM on May 1 of each year during the term of the Plan. The Company notes that any changes to the Guidelines during the term of the Plan that necessitate material expenditures by the Company to satisfy such standards may be treated as Exogenous Costs pursuant to Section II. C. 3 of the Term Sheet. Id.

As set forth in Exh. DOER 1-4, the Company will calculate relevant penalties and offsets consistent with the Guidelines, as clarified by the Department, and will provide calculations supporting any penalties or offsets in its May 1 PCM filing; again, the Company's proposal seamlessly integrates PCM and service quality issues in any administratively efficient manner. Id. In addition, under the Company's proposal, the level of penalties with respect to performance standards will be adjusted to account for customer service guarantee payments in the relevant year (i.e., (i) missing or being more than four hours later for a scheduled service appointment or (ii) failure to notify a customer of a scheduled service outage). Id. see D.T.E. 99-84, pp. 37-38.[25] Further, as set forth in Exh. DOER 1-4, the Company will comply with the relevant reporting requirements of Section VIII of the Guidelines in its separate, annual March 1 filing required by D.T.E. 99-84, including reporting data for unaccounted for gas, restricted work day rate, damage to Company property, capital expenditures, and spare component and acquisition inventory policy and practice. Id. In addition, the Company will satisfy the consumer survey requirement of Section III. C. of the Guidelines in its mandatory March 1 filings and the Company's bills will

[25] As set forth in D.T.E. RR-57, rescheduling of an appointment agreed upon by a customer and the Company is not deemed a missed appointment.

be revised to include the information required in Section XI of the Guidelines. The Company proposes to satisfy the data collection reporting obligation within its March 1 and May 1 filings. Id.; see D.T.E. 99-84, p. 4.

In sum, the Company's PCM filing fully embraces all aspects the Department's generic service quality standards. Such standards will help to ensure that customers continue to receive excellent quality of service during the term of the PCM.

10. Berkshire's Proposed Implementation Of Rate Changes And Annual Review Process is Administratively Efficient.

As Ms. Zink and Dr. Gordon testified, following the 31-month rate freeze, annual rate changes, if any, under the PCM would take effect, beginning in 2004, on September 1 of each year during the term of the Plan. This annual review should be straightforward, with the Company making a filing on May 1st of each year (for effect on September 1st), beginning in 2004. As Dr. Gordon emphasized, the annual review should not be viewed as an opportunity to change the terms of the PCM Plan, but should simply implement its terms. Exh. BG-3, p. 18.

There are three, straightforward steps to this annual review. First, the Company will determine the average change to its rates based on the application of the PCM formula described in the Term Sheet, namely the inflation factor less the enhanced productivity offset plus or minus any exogenous costs and minus any relevant service quality performance-related penalty. Second, Berkshire will utilize the requested limited pricing flexibility so that the Company can serve customers in danger of switching to an alternate fuel, which would result in an increase in costs to all remaining customers. Third, the Company will adjust each rate component within a class by no more than the rate of inflation (unless exogenous costs make a particular year's adjustment higher than the rate of inflation in which case such higher percentage would be the upper limit) in order to maintain stability in rates while, at the same time, enabling the Company to implement rates that are closer to the Department's goal of achieving equalized rates of return. Exh. BG-22, p. 10.

In sum, consistent with the Department's policy that a core goal of price cap plans is "a reduction in regulatory and administrative costs," the mechanics of implementing Berkshire's PCM are straightforward and administratively efficient. Boston Gas, D.P.U. 96-50, at 320; Incentive Regulation, at 64.

C. Berkshire's Plan is Carefully Balanced and is Presented as an Integrated Proposal.

Dr. Gordon compellingly testified:

> So in summary, my view is that this is a balanced plan when looked at in its entirety, the pieces fit together well, and the plan should be viewed as a whole, not simply one piece at a time or as a menu from which particular items can be selected and others rejected. It is meant to be a coherent whole. It is relatively simple, appropriate for a company the size of Berkshire Gas, and in my view deserves to be approved by the Department.

Tr. 1, p. 12.

As Dr. Gordon testified, the Company's PCM proposal is carefully balanced and is presented as an integrated proposal with each of its core elements inter-relating. The Company respectfully requests that the Department review the PCM proposal in this light. Indeed, when addressing an incentive ratemaking proposal proposed for effect over an extended, ten-year period, it is crucial that core elements of the plan are not materially altered, lest the plan as a whole become no longer viable. Tr. 3, pp. 298-300. Both Dr. Gordon and Ms. Zink provided concrete examples relating to this concern in their oral testimony. In particular, when questioned with respect to the term of the initial thirty-one month rate freeze, Dr. Gordon stated:

> Is a 48-month [rate freeze] period any less convenient than a 31-month period? I think it changes fundamentally the calculus that was involved in balancing all the elements of the [P]lan. The 31 months wasn't picked completely out of the air. It was a judgment, admittedly judgmental, that was done in conjunction with other features of the [P]lan, such as what the consumer dividend would be, the company's expectations of what inflation might turn out to look like, what the size of the exogenous adjustments were, and their own estimation of how likely it was that those would have to be applied, and so on. In other words, it was one piece of a package. If a freeze were to be extended out to 48 [months] -- which is four years, by the way, four full years -- then it might well be the case that adjustments, offsetting adjustments, would have to be made in other variables. This was an attempt to put together a package that would have certain types of benefits to consumers but also allow the company reasonable opportunity to make a profit as it goes forward, to recover -- an opportunity, but not a guarantee, to get back some of the merger expenses and the like.

Tr. 1, pp. 138-139; <u>see</u> <u>also</u> Tr. 3, pp. 298-300.

Similarly, when questioned about the Company's willingness to forego sharing in merger-enabled gas cost savings resulting from the BP alliance, Ms. Zink emphasized.

> If the [P]lan were aborted or there were a significant change to the [P]lan as proposed, then the [C]ompany would . . . possibly seek the opportunity for recovery of some savings that may be generated from gas cost savings. However, as I stated earlier, if this [P]lan is approved generally as proposed, it is a ten-year plan, the same price calculation is in place, and there is no material change to the plan as proposed, the [C]ompany will not be seeking recovery for any merger-enabled gas cost savings. The only time the [C]ompany would consider that would be if the Plan is significantly altered from the [P]lan as filed or it is truncated for some reason earlier than the ten-year period.

Tr. 8, p. 971.

In sum, the Company respectfully requests that the Department view its PCM Plan as an integrated whole and not pick and choose selective items as argued for by the Attorney General and the DOER. While the Company is confident that the Department will reach a just and reasonable result in this case, it must reserve its legal rights to seek compensatory rates, including, if necessary, merger-related costs, in the event the plan is materially altered from that proposed herein. The Company emphasizes that it is not putting a "take it or leave it" proposition on the table with the Department. The Company understands that in any ratemaking proceeding, there is a bandwidth of reasonable results and certain Department-mandated adjustments to the Plan are the norm. The Company accepts this fact so long as such adjustments do not fundamentally or materially alter the Company's opportunity to generate benefits for shareholders under the Plan, including a fair rate of return and an opportunity to recover merger costs. That said, the Company emphasizes that its proposed PCM Plan is squarely within the bandwidth of reasonableness -- indeed, as detailed above, the Company has consistently sought to avoid taking extreme positions in this case and each element of the Company's proposal is firmly supported by well-established Department precedent. Exh. BG-1, p. 3.

D. Berkshire's PCM is Consistent with Sound Economic and Regulatory Policy.

Sections II.B and II.C supra demonstrate how the Company's PCM Plan is consistent with extensive Department precedent and fits together as an integrated package. From a more conceptual standpoint, Dr. Gordon's testimony also details how the Company's proposed PCM Plan is grounded in sound economic and regulatory policy. In summary, Dr. Gordon testified:

?? The PCM Plan can provide strong incentives for productive efficiency that would benefit consumers, utility shareholders, and society generally. Price-cap regulation provides strong efficiency incentives to the extent that it increases the utility's ability to appropriate the benefits that derive from its efforts to increase its efficiency and, concurrently, decreases the utility's ability to pass cost increases on to customers. Increasing a utility's incentives to improve efficiency ultimately benefits consumers by reducing the utility's costs. Exh. BG-3, p. 9.

?? The PCM Plan can provide strong incentives for technological innovation. The Company will have strong incentives to innovate if it has a firm assurance that it will be able to retain benefits resulting from its risk taking. Exh. BG-3, p. 9.

?? The PCM better emulates the incentives that firms face under competition. A firm that is regulated under a price-cap plan must regard the maximum level of prices as beyond its control and faces the same incentives to reduce costs and expand output as firms in competitive markets. Exh. BG-3, pp. 9-10.

Importantly, Dr. Gordon also testified, that:

?? From the standpoint of customers, price-cap regulation provides major benefits. Price-cap regulation provides greater price stability and predictability. Indeed, the use of a productivity offset provides a strong assurance that any price increases under Berkshire's PCM would be less than the rate of inflation. Exh. BG-3, pp. 10-11.

?? Price-cap regulation tends to shift risks from consumers to the utility. Exh. BG-3, p. 11.

?? An appropriately implemented price cap plan, such as Berkshire's, reduces the regulatory administration costs of overseeing the utility's rates. These decreased costs ultimately benefit customers. Exh. BG-3, p. 11.

?? Price-cap regulation better accommodates the transition to competition. Exh. BG-3, p. 12.

?? The pricing flexibility that is included in the PCM Plan can improve the ability of the Company to retain customers with competitive options, which benefits utility consumers generally by allowing Berkshire to spread its fixed costs over a broader customer revenue base. Exh. BG-3, pp. 12, 27-28.

In sum, Berkshire's proposal (a) is entirely consistent with the overarching economic and regulatory policies reflected in many Department decisions (see, e.g., Boston Gas, D.P.U. 96-50; Incentive Regulation, D.P.U. 94-158) and (b) provides the substantial benefits discussed in Dr. Gordon's expert testimony.

E. **Berkshire's PCM Appropriately Addresses Energy East Merger-Related Issues.**

As Mr. Allessio, Ms. Zink and Mr. Kruszyna all testified, Berkshire is taking the pro-customer step of proposing -- in the context of its PCM which, inter alia, does not require earnings sharing -- to strip out of rates all costs (over $66 million) related to the September 1, 2000 merger in which Berkshire became a subsidiary of Energy East. In return, Berkshire asks for the opportunity (but not the guarantee) of offsetting these costs through the retention of savings generated during the term of the PCM. Exh. BG-1, pp. 20-23; Exh. BG-3, pp. 12-14; Exh. BG-22, p. 16; Tr. 1, pp. 11, 82; Tr. 2, pp. 164-165; Tr. 8, pp. 942-946. The Department has consistently accorded companies the opportunity to recover merger-related costs so long as such recovery does not result in "net harm" to customers.[26] See, e.g., Boston Edison Company, et al., D.T.E. 99-19 (1999); Eastern Enterprises/Colonial Gas Company, D.T.E. 98-128 (1999); Northern Indiana Public Service Company/Bay State Gas Company, D.T.E. 98-31 (1998); Eastern Enterprises/Essex County Gas Company, D.T.E. 98-27 (1998); New England Electric System/Eastern Utilities Associates, D.T.E. 99-47 (2000). The Company's PCM proposal not

[26] "The Department's authority to review and approve mergers and acquisitions is found at GL. c. 164, §96, which, as a condition for approval, requires the Department to find that mergers and acquisitions are consistent with the public's interest. . . . The public interest standard. . . must be understood as a 'no net harm, rather than a net benefit test.'" Fall River Gas Company/Southern Union Company, D.P.U. 00-25 at 7 (2000) ("D.T.E. 00-25").

only results in "no net harm" to customers as a result of the Energy East merger, but it produces affirmative benefits for customers as a result of such transaction.[27]

Dr. Gordon testified that it is particularly important that the Department's ratemaking policies not penalize Berkshire by failing to allow the Company an opportunity to share in the efficiency benefits that its Energy East merger can provide. Exh. BG-3, pp. 12-14. He emphasized that mergers and acquisitions can potentially provide an effective way to reduce costs borne by consumers, and increase the value that they receive, "by achieving economies of scale, scope, and learning." Id. Indeed, in Investigation By The Department On Its Own Motion For The Purpose Of Establishing Guidelines And Standards For Acquisitions And Mergers Of Utilities, And Evaluating Proposals Regarding The Recovery Of Costs For Such Activities, D.P.U. 93-167-A at 3 (1994) ("D.P.U. 93-167"), the Department (1) stated that it is interested in all potential measures that promote efficiency; (2) found that "mergers or acquisitions may represent one of many measures that could achieve savings, efficiencies, increased reliability, and better quality of service" in Massachusetts; and (3) stated that it "expects all utilities to explore thoroughly all cost-savings measures and potential opportunities to achieve efficiencies of all kinds." Id. at 3. Through its merger with Energy East, Berkshire has complied with these directives and is achieving benefits for its customers.[28]

Dr. Gordon strongly supported the Company's proposal to address all merger-related issues through the PCM:

[27] The Company has the right to "reasoned consistency" in the treatment of its PCM proposal as compared with the Department's treatment of other merger-related rate plans. See Boston Gas Company v. Department of Public Utilities, 367 Mass. 92, 104-105, (1975).

[28] See also D.P.U. 93-167-A, at 4 (rate plans addressing mergers should provide a "framework that ensures that utilities… provide safe, reliable and least cost service").

> By setting Berkshire's rates as if the merger with Energy East had not occurred, and providing benefits to utility customers through the operation of the PCM, utility customers will share in the benefits of the merger. . . through the operation of Berkshire's PCM. When this approach is used, there is no need to require a utility to quantify merger savings or to require frequent rate cases, which would provide a disincentive to achieving cost savings. A better -- and incentive-based -- approach would be to implement the PCM.

Exh. BG-3, p. 14.

As indicated in the above quotation from Dr. Gordon, by using cast off rates calculated on a pre-merger basis, the Company is able to provide benefits to customers and present a more streamlined, performance based-approach with respect to the Energy East merger. By using pre-merger cast off rates, the Company eliminates the need for detailed, costly studies of merger costs and merger-enabled benefits.[29] Exh. DTE 2-3. Berkshire is aware that certain other Massachusetts companies, in connection with requisite Department approval of their mergers, have sought full recovery of all merger-related costs, including all transaction costs and acquisition premium costs. In order to satisfy the Department's G.L. c. 164, §96 "no net harm" standard, these companies elected to present merger cases detailing and seeking recovery of all merger-related costs and then showing, or agreeing to show at a future date, that all such costs were offset by quantifiable, merger-enabled benefits. ("The [G.L. c. 164, §96] public interest standard. . . must be understood as a "no net harm" rather than a "net benefit test". D.T.E. 98-128 at 5). The Company is differently situated. Berkshire's merger with Energy East was undertaken at the holding company level and no formal Department approval of the merger was necessary under G.L. c. 164, §96. Also, since the Department's initial merger orders, the Department has

[29] By way of example, as noted in Boston Edison Company/Cambridge Electric Light Company et al, D.T.E. 99-19 (1999), the regulatory approval expense related the approval of the Boston Edison/Com/Energy merger, including attorneys and consultant's fees, **was $5,076,000**. Id. at pp.

more recently encouraged companies, including Fall River Gas Company (in D.T.E. 00-25) and North Attleboro Gas Company (in D.T.E. 00-26), to address merger costs in future performance or incentive rate proposals. Exh. DTE 2-3.[30]

After reviewing these matters and different approaches, and consistent with the Department's recent directives, the Company elected the more streamlined, customer-focused approach presented in this case, where Berkshire is using a pre-merger 2000 test year for cast off rates and stripping out all merger-related costs. Because these costs are not being pushed down to customers, it is not appropriate to expend the very substantial funds and resources necessary to attempt to quantify offsetting benefits. Exh. BG-3, p. 14. Not only does this help Berkshire, a small company, minimize rate case expenses, it also avoids the costs and burdens of detailed compliance filings and proceedings in the future. See also Boston Gas Company, D.P.U. 94-14 (1995) (utilities must balance accuracy and costs in deciding whether to undertake costly quantitative studies).

As noted in Exh. DTE 2-3, if Berkshire were to make adjustments in its test year for post-merger actions/benefits, as argued for by the Attorney General, then it would also be necessary to roll in all of the merger-related costs and higher expenses (e.g., tax rate) that were incurred to

33-34. This amount far exceeds the Company's costs in presenting this case, which is particularly notable in that Berkshire's case also involves a fully litigated base rate proceeding.

[30] In Fall River, D.T.E. 00-25, the Department directed "Southern Union to submit an incentive-based proposal as part of its next base rate filing for its Fall River division. Southern Union and its shareholders are placed on notice that they bear the burden to demonstrate the propriety of its **proposed PBR filing** and bear the risk as to whether incentive regulation will provide sufficient revenues to offset the acquisition premium and transaction costs arising from this merger." Id. at pp. 12-13. See also North Attleboro Gas Company, D.T.E. 00-26 at 11-14 (emphasis added).

achieve these benefits.[31] Berkshire's PCM Plan, utilizing a pre-merger test year on a consistent basis, avoids the inclusion of all of these costs, which is to the ultimate benefit of customers. Lastly, even though Berkshire is not seeking merger approval in this case, it is important to note that its proposal is consistent with the Department's "no net harm" merger approval standard, because not only are Berkshire's customers **not** harmed by its proposal which uses pre-merger cast off rates without inclusion of any merger costs, they are affirmatively **benefited** by an initial rate freeze, a ten-year price cap, a guaranteed consumer dividend and the adoption of the D.T.E. 99-84 service quality standards. Exh. DTE 2-3.[32]

F. The Intervenor's Complaints Regarding Certain Aspects of the PCM are not Supportable.

1. LBR as an Exogenous Cost; the Company's Proposal is Squarely Supported by Department Precedent and is Reasonable.

The Attorney General and the DOER argue because the Department's rolling period methodology[33] policy with respect to LBR, is known in advance, the PCM should not explicitly

---

[31] In such an instance, the failure to roll in the costs necessary to produce such benefits as advocated by the Attorney General would improperly deny the Company "reasonable compensation" and would essentially result in "confiscatory" rates. See New England Tel. & Tel. Co. v. Department of Pub. Utils., 331 Mass 604, 615 (1954) (utilities entitled to reasonable compensation); Boston Edison Co. v. Department of Pub. Utils., 375 Mass 1, 10 (1978) (confiscation occurs when a utility is deprived of the opportunity to realize a fair return on its investments). Berkshire's symmetrical approach entirely avoids these issues.

[32] The Department has applied the §96 "no net harm" standard to rate plans where merger costs of parent companies are pushed onto the books of regulated subsidiaries. See Boston Edison et al., D.T.E. 99-19 at 7-8 (1999). To the extent the PCM is deemed to have a similar effect (even though no merger costs are rolled into the Company's rates), as discussed above, the Plan clearly satisfies the "no net harm" test.

[33] Under the rolling period methodology, "LBR associated with the specific year of DSM implementation would be recovered for a period equal to the average length of time between each of a Company's last four rate cases, or until new rates take effect subsequent to a new base rate proceeding." Colonial Gas Company, D.P.U. 97-112 at 11 (1999).

address LBR as an exogenous cost.[34] This argument is simply wrong. In its letter order dated March 30, 2001 in Bay State Gas Company, D.T.E. 00-106, the Department stated:

> In Colonial Gas Company-Eastern Enterprises Merger, D.T.E. 98-128 (1999), the Department "recognize[d] that a change in the Department's regulatory policy, including our LBR policy, that had cost consequences, would be encompassed under our definition of an 'exogenous cost.'" Id. at 55 (emphasis added). The Department further held that "[t]o recover exogenous costs during the Rate Plan, the Petitioners would be required to propose exogenous cost adjustments, with supporting documentation and rationale, to the Department for determination as to the appropriateness of recovery of the proposed exogenous costs." Id., citing NIPSCO-Bay State Acquisition, D.T.E. 98-31 (1998) at 17-18. Consequently, the Department concludes that Bay State, or any other LDC seeking to recover LBR not recouped through application on the RPRM, must submit an exogenous cost calculation filing with appropriate supporting documentation for the Department's review. The Department notes that Colonial Gas Company is currently seeking recovery in this manner in D.T.E. 00-73, and that Bay State also has considered this approach. See Bay State Petition at 9 fn. 4. Because an exogenous cost calculation filing permits the Department to conduct a comprehensive review of the cost consequences of the change in our LBR policy to determine whether recovery is warranted, we determine that this approach is in the public interest.

Id. This precedent allows the Company to seek recovery of LBR lost as a result of the rolling period method during the term of the Plan. Moreover, such a position is clearly supported by the policies underlying the Department's support for exogenous cost filings in numerous other cases.

As Mr. Allessio, Ms. Zink and Dr. Gordon all testified, DSM programs are unique -- Dr. Gordon refers to them as "directed investments" undertaken pursuant to regulatory mandate that are not controlled by the Company. Exh. BG-3, p. 25; Tr. 3, pp. 270-274. DSM programs have many benefits for customers and the environment, but they also reduce sales. While the effect of truncating LBR recovery may be somewhat different in nature than other exogenous costs, it is clearly a factor beyond the Company's control (i.e., a regulatory mandate) that needs to be addressed upfront if Berkshire is to implement any long term price cap plan. This is especially

[34] The DOER's Initial Brief appears to at least concede that some exogenous cost recovery for

necessary because, historically, a utility's remedy when faced with excessive unrecovered LBR was to file a rate case -- indeed, unrecovered LBR is one of the important factors driving the Company's current need for rate relief. Exh. BG-1, pp. 13-17; Tr. 3, pp. 270-271. In a price cap model, however, that remedy is not available. Accordingly, Berkshire's PCM Plan prudently addresses the issue upfront, lest the Company experience serious revenue deficiencies in the later years of the PCM Plan that are similar to the deficiencies it is now facing as a result of the application of the rolling period method. Tr. 3, pp. 270-274.[35] Indeed, as Mr. Allessio testified, the application of the rolling period method has reduced the Company's revenues by approximately $500,000 in 2001 -- a major loss for a Company of Berkshire's size. Exh. BG-1, pp. 16-17.

Berkshire's LBR proposal in a nutshell is as follows: When the Company implements DSM during the PCM period, it agrees that throughout that period it will recover LBR, but that LBR recovery will be subject to, and limited by, the rolling period methodology. This does not present any issues in the early years of the PCM because, assuming a rolling period of approximately four years, Berkshire will be eligible for four full years of LBR recovery for all measures installed after the test year. Accordingly, as Ms. Zink testified, Berkshire does not face any LBR issues until 2005 (and possibly 2006) at the earliest. Tr. 3, pp. 273-274; 348-349.

---

unrecovered LBR might be appropriate in certain circumstances. See DOER In. Br. at 34.

[35] If the PCM does not address this issue up-front, a perverse incentive to eliminate or dramatically scale back DSM efforts is created. For this reason, Berkshire expects that long-time proponents of cost-effective DSM efforts, such as DOER, should support its proposal. The Company emphasizes that it has worked cooperatively and constructively with the Attorney General and the DOER, as well as LEAN, on the development and implementation of its DSM programs. Tr. 3, pp. 278-279. The Company has appreciated these agencies' significant contributions and looks forward to maintaining these constructive relations. The Company is particularly appreciative of these agencies' assistance in bringing DSM programs to its valued lower-income customers.

Because of the cumulative nature of DSM savings, however, lost revenue will become a more significant issue in each subsequent year, especially the final few years, of the PCM. Berkshire's proposal is simply that at such future date as its lost LBR recovery resulting from the application of the rolling period method rises to such a level as to be materially detrimental that it have the opportunity to recover the portion of such costs in excess of $50,000. Term Sheet at 3; Tr. 3, pp. 353-354. For example, in 2007, if the Company has $75,000 of LBR that it is not recovering as a result of the rolling period methodology, it would be entitled to collect $25,000 as an exogenous cost which is comprised of the difference between the $50,000 exogenous cost threshold and its actual loss. It is important to emphasize that Berkshire is **not** seeking a dollar-for-dollar, make whole arrangement, but is only seeking to protect against a clearly foreseeable issue that could result in a major revenue shortfall during the latter stages of its "stay out" period. Id.

Ms. Zink made clear that if the Company were not allowed such a mechanism in the PCM Plan, it would it be forced to re-evaluate its future DSM efforts. Tr. 3, pp. 356-358. As Ms. Zink testified, the Company has embraced DSM since its inception in Massachusetts (see LEAN In. Br., p. 1), but has always had a mechanism to protect against the accompanying sale reductions. Without such a mechanism in a long-term price cap plan, Berkshire would need to re-evaluate its support of DSM efforts on a going forward basis. Id.

Finally, counter to the DOER's implications, Berkshire's LBR proposal is not in any way inconsistent with the D.T.E. 01-29 Settlement. Tr. 3, pp. 273-274. First, the Company's proposal expressly anticipates that, as agreed in the D.T.E. 01-29 Settlement and required for all Massachusetts LDCs, all LBR recovery will be subject to the rolling period methodology throughout the term of the PCM. The Company's proposal merely addresses base rate adjustment issues in the context of the PCM and does not at all affect the conservation charge ("CC") recovery issues addressed in the D.T.E. 01-29 DSM Settlement. Second, the settlement expressly is limited to the specific matters included in it. The settlement did not preclude or address in any way price cap or base rate plans and indeed expressly provided that "the making of this settlement establishes no principles or precedent and shall not be deemed to foreclose any party from making any contention in any future proceeding, except as to those issues that are resolved by approval of this settlement agreement." Exh. BG-2, Attachment A, p. 11. Third, and perhaps most importantly, the D.T.E. 01-29 Settlement explicitly only addresses a three year period ending April 30, 2004. As noted above, there are no issues foreseen with respect to the rolling period method until at least 2005, well after the expiration of the D.T.E. 01-29 Settlement. In sum, in no way is the D.T.E. 01-29 Settlement inconsistent with Berkshire's LBR proposal in this case. Id. at p. 3; Tr. 3, pp. 273-274.

2. **Short Responses to Certain Misplaced Arguments of the Attorney General and the DOER Regarding the PCM.**

In this Section II. F. 2, Berkshire briefly rebuts several of the Attorney General's and DOER's misplaced arguments with respect to the PCM.

?? **Annual Rate Adjustments** As Ms. Zink testified, the average time between the Company's last four rate proceedings, inclusive of the almost nine years since the Company's last base rate proceeding, D.P.U. 92-210, is 4 years. See e.g. Tr. 3, pp. 273-274; 348-349. In this proceeding, the Company is offering to refrain from filing a base rate proposal for at least 10 years, **two and one-half times** the historical average period between rate cases. In light of these historical averages, which are consistent with those of other Massachusetts LDCs, it is unrealistic to expect that the Company would be able to refrain from filing a base rate proceeding for another 8 years, much less a decade, without the modest inflation adjustment provided in the PCM. At page 2 of his brief, the Attorney General grossly mischaracterizes the PCM by suggesting that such an adjustment is the equivalent of consistent annual rate increases. This argument is especially hollow given the Company's proposal of a 1% guaranteed consumer dividend offsetting any inflation adjustments. Indeed, in direct opposition to the Attorney General's claims, in years where the inflation factor is less than 1%

and absent any exogenous costs, Berkshire's customers will receive nominal rate **decreases** under the PCM. See Section III.B.5 supra.

?? **Merger Costs** The Attorney General's argument that the Department should reject the recovery of any merger-related costs mischaracterizes a core element of the PCM. AG In. Br., pp. 1, 11. As the Company's witnesses testified, under the terms of the PCM, Berkshire is not seeking to add any merger-related costs to rates under the PCM. Indeed, all such costs have been stripped of the Company's rates. See Section II.E supra. Relatedly, counter to the Attorney General's suggestions (AG In. Br., p. 5), the Berkshire/Energy East merger was conducted at the holding company level and did not require any prior Department pre-approval, as has been the case in a number of other recent mergers, See, e.g., KeySpan/Eastern Enterprises merger and Boston Edison/Commonwealth Energy merger (which merger was undertaken at the holding company level and closed prior to the Department's review of the related rate plans in D.T.E. 99-19). Nor did the Company somehow fail to file a timely request for a deferral of a balancing test required by D.P.U. 93-167-A (1995) as implied in footnote 5 of the Attorney General's Brief given 1) that the Company is not seeking a detailed finding by the Department that the costs of the merger are offset by projected savings of the merger, and 2) that, to any extent that rate treatment for merger costs is being established in this proceeding, such costs were incurred during the test year which is the subject of this proceeding. See generally Section II.E supra. Customers are further benefited by Berkshire's PCM proposal because, unlike other Massachusetts companies that have indirectly included gas cost savings resulting from mergers in their rates by including the benefits of such savings as offsets to merger costs, Berkshire is taking the pro-customer step of flowing back to customers savings from the BP Portfolio Optimization Agreement approved in D.T.E. 01-41. Tr. 8, p. 971; see also Section II.E supra.

?? **Cast Off Rates** The Attorney General egregiously mischaracterizes Mr. Allessio's testimony. AG In. Br., p. 9. Mr. Allessio did not testify in any manner whatsoever that the Company's proposed cast off rates might result in a revenue requirement that is higher than its actual cost of providing service. Given that cast off rates do not include merger costs, if anything, the Company's proposal would tend to understate the current cost of providing service.

?? **Flow Back of Service Quality Penalties** With respect to the flow-back of any service quality penalties during the 31-month rate freeze period (AG In. Br., p. 59), the Company's proposal is that any such penalties should be accrued and flowed back following the end of the rate freeze. Exh. BG 22, p. 10. As Ms. Zink testified, this proposal is made solely for administrative efficiency and to reduce the regulatory costs that could accompany the revision of rates for a minimal amount. Id. Should the Department prefer, however, the Company stands willing to flow-back any such penalties during the rate freeze period.

?? **Pricing and Rate Design Flexibility** Counter to the Attorney General's argument on page 61 of his brief, the Company is **not** proposing to recover any discount given to one customer from other customers. The Attorney General's brief blurs two distinct provisions in the Term Sheet: 1) pricing flexibility and 2) rate design flexibility. First, with respect to pricing flexibility, the Term Sheet allows the Company to offer discounts to at-risk customers provided that the contract price exceeds the relevant marginal cost price. Term Sheet at 4. In such an event, as Dr. Gordon testified, "the risk of making an error on the discount does lie with the shareholders not with the other customers. . . . The virtue of the price cap type plan is that if the management makes a mistake and gives a discount to somebody who didn't really need a discount, it's their bottom line that eats it." Tr. 8, pp. 924-925. In sum, no discount under this provision is recovered from any other customers. See Section II.B.8, supra. Second, with respect to rate design flexibility, the Plan merely allows the Company to move rates gradually toward equalized rates of return through annual adjustments as is explicitly allowed in extensive Department precedent. See e.g. D.P.U. 96-50 at 332-333. The implementation of this policy, notwithstanding the Attorney General's arguments to the contrary, does not constitute "discounting the rates of one customer" at the expense of any other customers. Cf. AG In. Br., pp. 59-62.

?? **The Company's Service Quality Proposal** The DOER's procedural arguments with respect to the Company's proposal in its initial filing of July 17 to fully implement the generic service quality standards of D.T.E. 99-84 (and the DOER's related push to somehow dismiss this case) are merely a rehash of the arguments adduced in the Attorney General's October 1, 2001 Motion to Dismiss. DOER Brief, pp. 7-21. Rather than present a detailed response to such baseless accusations in this brief, the Company refers the Department to its Response to said Motion to Dismiss which was filed by the Company on October 9, 2001 ("Response") and is incorporated herein by reference.[36] What is perhaps most notable about the service quality arguments in the DOER's brief is that they entirely ignore the very substantive materials and data submitted with respect to the establishment of the Company's service quality benchmarks. See Section II.B. 9 supra.[37] These materials make it absolutely clear that the Company is completely

[36] The Company would emphasize, as it did in its Response, that in reviewing motions to dismiss, the Department must not "merely consider whether a company has failed to comply with the letter of a filing request, but also must weight the degree of prejudice to the Department and intervenors resulting from [any] deficiency." Dedham Water Company, D.P.U. 85-119 at 16 (1985). Absolutely no prejudice has befallen the DOER or the Attorney General in this case. Indeed, since the Attorney General's initial filing of his Motion to Dismiss, there have been 17 days of evidentiary hearings allowing the Attorney General and the DOER to review fully any and all service quality matters. In contrast, the prejudice to the Company in granting the Motion to Dismiss after 17 days of hearings would far outweigh any alleged prejudice to the Attorney General or the DOER. Accordingly, the arguments set forth in the Company's Response are even more dispositive at this date.

[37] D.T.E. 99-84 does not require the establishment of individual service quality measures until 3 full years of valid supporting data for the given measure are in existence. The fact that the Company, like many other LDCs in Massachusetts, does not have 3 full years of data for each

satisfying the Department's service quality requirements. See e.g., Exh. DOER 1-4. Indeed, there is no doubt whatsoever that the Company is proposing to do anything other than implement the exact requirements of D.T.E. 99-84 as soon as the PCM becomes effective.

?? **Annual Exogenous Cost Reviews** The DOER's suggestion that the Company's PCM proposal somehow allows the Company to make automatic exogenous cost adjustments for LBR at its discretion and "without Department review" is simply wrong. DOER Brief at 29; 32-37. The Term Sheet expressly provides that any exogenous cost proposals, including those relating to LBR, will be subject to the Department's scrutiny and approval in Berkshire's annual May 1 filing for effect on September 1 of each year. Term Sheet, pp. 1-2. Relatedly, notwithstanding the DOER's arguments to the contrary, the Company's proposal to reference LBR in its exogenous cost definition is expressly consistent with the March 30, 2001 letter order in D.T.E. 00-106. The Company fully expects that, based upon this letter order, all future LDC rate plans' definition of exogenous costs will include language similar to the Company's.

In sum, Berkshire's PCM Plan succeeds in advancing the Department's traditional goals of safe, reliable and least cost energy service and, at the same time, promotes the Department's objectives of economic efficiency, cost control, lower rates and reduced administrative burdens. See Boston Gas, D.P.U. 96-50 at pp. 242-243. As demonstrated above, each component of Berkshire's PCM complies with Department precedent and, moreover, the PCM -- as an integrated and complete proposal -- produces very substantial benefits for customers. Indeed, with the approval of the Plan, Berkshire's customers will be ensured a decade of stable rates and high quality service. For all the foregoing reasons, the Company respectfully requests that the Department approve the PCM Plan.

---

service quality measure in no way indicates a failure to comply with the order in D.T.E. 99-84. To the contrary, the fact that the Company has service quality data already for most of the measures adopted in the order indicates its diligence with respect to these matters.